Main findings

Against that background, some of the main findings and implications which seem to have emerged from this study can be summarized as follows (for detailed tabulation, see "Analysis of responses" from page 18):

- FDI flows not only *went on rising during the recent recession*, but actually increased more rapidly during the five years through 1982 (which included three years of recession) than during the preceding five years. The implementation of previously planned investment provides one explanation. The impetus given to foreign investment by flat or falling demand in companies' parent countries and a tendency of trade barriers to promote foreign manufacturing as an alternative to exporting are other explanations. Investment into the United States was particularly strong (from other data it is estimated that the stock of FDI in the United States increased from $35 billion at the end of 1977 to $90 billion at end-1981).

- Further evidence of the maintenance of FDI flows during the recession of the three years through 1982 emerges from answers to Questions 1 and 2. More than 70 per cent of the respondents said their own *FDI had increased during that recession* and 66 per cent of the respondents said they believed the FDI of competitors in their industries had likewise increased.

- A maintenance of high rates of growth of FDI flows during the latest five years is suggested by the answers to Question 4 and supported by the data on net flows of the main industrial countries, summarized in Table 3 on page 17, and of FDI flows to LDCs, shown in chart 1 and chart 2, at nominal and real values respectively. The summary table B of answers to Question 4 shows that 56 per cent of respondents reported an increase of more than 25 per cent in their FDI in real terms during the five years through 1982, compared with 49 per cent which reported a similar increase during the five preceding years. However, the table suggests also a slowing down in the present five-year period, when only 29 per cent of respondents expect their real FDI to go on rising by more than 25 per cent. Nevertheless, 85 percent of the respondents still expect some real increase in their FDI during the current period. Since this survey was conducted before the present global economic recovery had fully started and when real and nominal interest rates were still above recent levels, the actual outturn for FDI during the current five years may prove better than suggested here, if the world economic recovery is sustained and if the cost of money falls further.

- The answers to Question 6 show that the number of respondent companies reporting a "pronounced increase" in their FDI during the largely

Summary Table B (Question 4)

Estimated and anticipated changes in real FDI

	1973-78	1978-82	1983-87
	(per cent of respondents)		
increase of:			
more than 50%	*31*	*36*	*9*
25-50%	*18*	*20*	*20*
up to 25%	*41*	*34*	*56*
no change or decrease	*10*	*10*	*15*

Note: It will be seen that the 27 per cent of respondents reporting "no change or a decrease" in their FDI "during the recent recession" in answer to Question 1, is very much larger than the 10 per cent giving the same answer to Question 4 above, part of which spans the five years through 1982 which includes two years of relatively rapid global economic growth in 1978 and 1979. That suggests some slowing down from 1980.

recessionary period of 1978-82 reported such an *increase in nearly all groups of countries* covered, namely the mature industrialized countries (the MICs), the newer industrialized countries (NICs) of Europe, Asia and South America, as well as in the less developed countries (LDCs); see page 23. Significantly, some maintenance of FDI is expected also in South America and, if that materializes, it will provide relatively more important channel for development capital to that region, where debt-servicing difficulties have been especially concentrated.

- However, two aspects deserve mention here. Firstly, much of the new FDI envisaged by respondents is expected to be concentrated in *new industries*, particularly high-technology. A second, related point, is that this survey has been produced almost exclusively with the help of *major international companies*. While these do include some of the most prominent high-technology firms, many of the smaller international companies in new fields are not included in the survey, nor are smaller international companies as a whole, whose combined influence on FDI trends may nevertheless be important at the margin. Among many possibilities this raises is that new FDI may prove larger than suggested by the answers in this study (for further information on our sample, see page 18).

- *The partly counter-cyclical trend of FDI* flows was brought out by many respondents in their comments on questions 1-4. In this respect they mentioned shrinking opportunities in their home markets, the need to compete more efficiently in host countries, the need to overcome a proliferation of nontariff trade barriers during recessionary periods, and the greater receptiveness of broadly defined developing countries to FDI at times of recession. Some comments under this heading included:

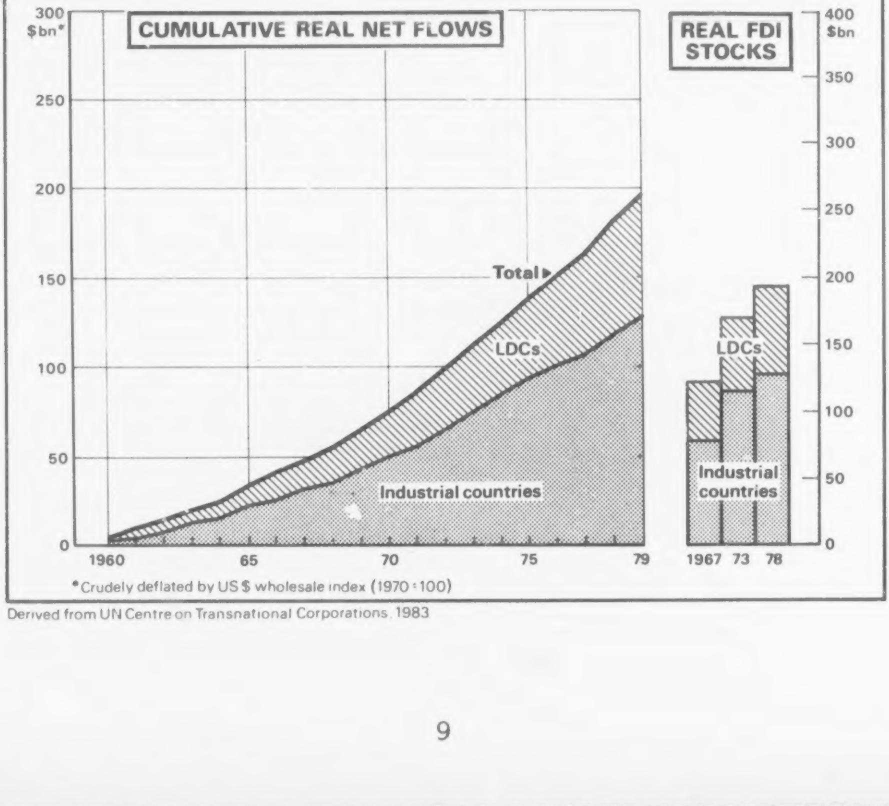
> "The poor rate of profit at home, compared with foreign opportunities."
>
> "Restrictions on economic growth by recession are seen to be counterbalanced by extending our group's presence into new localities."
>
> "Investments are made as a hedge against local competition, which is even fiercer in a recession."

However, some other influences were also mentioned as helping to maintain *FDI flows in bad times and good.* Among the comments here were, "Spending commitments are often long-term and irreversible, especially in capital-intensive industries" and "Current expenditures probably anticipate future market recovery and expansion". In the same vein, "The long term economic outlook in many countries continues to remain favorable."

- Several respondents attributed the *growth and planned growth* of their FDI to the fact that they specialized in "growth industries" like office machinery and high technology products. Indeed the survey yielded impressionistic evidence that FDI will increasingly be spearheaded by companies in such fields.

2

Real long-term foreign direct investment trends



*Crudely deflated by US $ wholesale index (1970 = 100)

Derived from UN Centre on Transnational Corporations, 1983

Table 2

The financing of current deficits for all developing countries, 1982-95

	Billions of current dollars		Annual percentage growth		
	1982[a]	1995	1970-80	1980-82	1982-95
Current account balance[b]	-118.2	-276.2	17.2	41.7	6.7
Net capital flows	85.2	294.2	20.4	2.2	10.0
Official development assistance	23.9	81.2	17.9	-1.0	9.9
Official nonconcessional loans	11.0	42.0	24.5	5.6	10.9
Private loans	35.0	109.6	22.3	-0.4	9.2
Private direct investment	15.3	61.4	18.6	12.5	11.3
Use of reserves and other capital[c]	33.0	-18.0	. .	. .	. .
Memorandum items					
Debt outstanding	548.0	1,996.8	19.9	13.7	10.5
Official	199.0	809.8	16.5	12.5	11.4
Private	349.0	1,187.0	22.3	14.3	9.9
Resource gap as percentage of GNP	3.7	1.6	n.a.	n.a.	n.a.
Current account deficit as percentage of GNP	5.0	2.7	. .	. .	. .
Net capital flows as percentage of GNP	3.6	2.9	. .	. .	. .
Debt service as percentage of GNP	4.7	3.5	. .	. .	. .
Debt service as percentage of exports	20.7	12.0	. .	. .	. .
Interest payments as percentage of GNP	2.1	1.5	. .	. .	. .
Deflator[d]	95.7	213.8	10.3	-1.6	6.4

n.a. Not applicable.
. . Not available.
a. Estimated.
b. Excludes official transfers.
c. Short-term borrowing.
d. US dollar GDP deflator for industrial countries.
From: *World Development Report, 1983*, p. 33, 34, covering 102 LDCs.

- Within the MICs, where FDI is still largely concentrated, flows have been stimulated in recent years and continue to be by the quest for what several companies have termed *"safer locations."* But another factor is the persistence of nontariff barriers like requirements for different standards within the European Community. A non-EEC international company said its original hopes of rationalizing its European production had been frustrated partly by the persistence of such barriers, although it mentioned also differences of national markets.

- An important aspect of flows to developing countries broadly defined is that even when relatively small in terms of total FDI flows, they nevertheless represent *large inflows for the host countries.* Direct investment capital flows from the DAC countries to developing countries rose fourfold over 11 years to more than $14½ billion in 1981 in nominal terms, an increase of about 55 per cent in real terms (see chart 3)*. The findings of our survey are consistent with the projection of the World Bank that the share of FDI in total private flows to LDCs may increase sharply in the years to 1995. (Movements in the share of FDI in past capital flows to LDCs are shown in charts 4 and 5)

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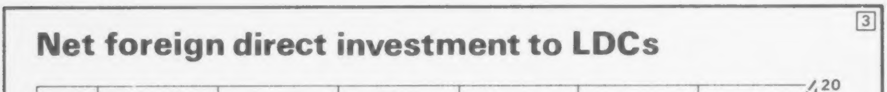
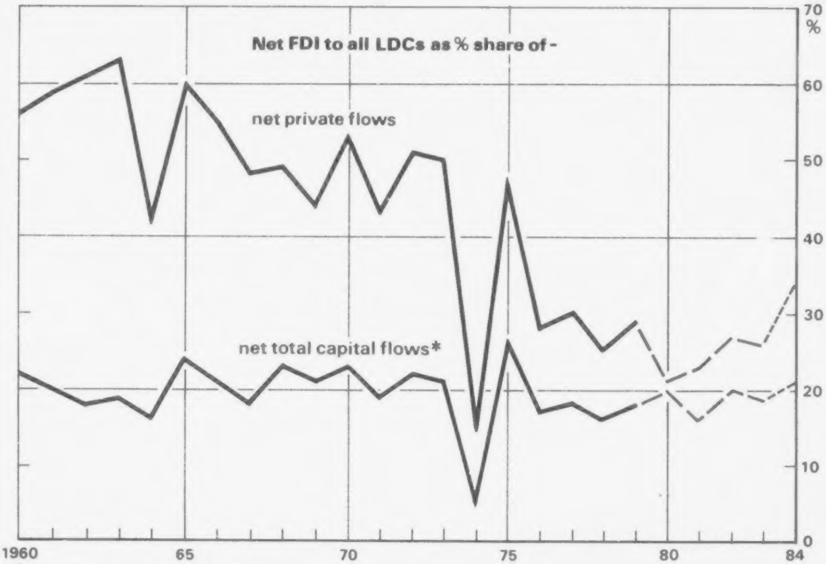
*Development Co-Operation, OECD, 1982, page 178.


Net foreign direct investment to LDCs

Source: OECD DAC 1983 for 1971-81, other international estimates and forecasts for 1982-84

- Another conceptual difficulty is raised by the growing practice of some international companies of subcontracting work, like the making of parts, to independent companies in foreign countries. This can be called *foreign direct investment without investment* because it does not represent FDI in the accepted sense. In such cases, the international company has no equity in the subcontractor. However, the practice does have some of the economic influences of FDI. Where the international company is the subcontractor's biggest single or only customer, as often happens, the local company has in effect been brought into existence and is kept in being by the international company. In this way, the international company creates, in another country, a new enterprise, employment and also the generation of new foreign exchange earnings for the subcontractor's country of domicile. Yet the international company achieves all this without going through the motions of conventional foreign direct investment or incurring the same kind of risks as those attaching to conventional FDI. Moreover, loan capital, where provided to a foreign subcontractor by an international company, has an arm's-length quality which does not attach to loan capital supplied by an international company to a foreign subsidiary. However, it does have a similar economic effect in providing a capital inflow for the subcontractor's country of domicile, releasing an equivalent amount of domestic savings in that country for alternative investment, though at the same time imposing a

The foreign direct investment contribution to LDCs 4



* from all official and private sources

Sources OECD 1960-79, provisional estimates and forecasts for 1980-84 from other international sources foreign exchange liability on the balance of payments of the subcontractor's country. In summary, the economic and balance of payments effects are almost identical to those of FDI, but this growing practice is not captured in FDI data, and rightly so because it is not FDI in the accepted sense. It is, however, a manifestation in another form of the economic contribution made by international companies.

- An aspect of FDI flows raised, but not at this stage clarified by the survey, is the extent of real and apparent disinvestment. *Disinvestment* by some international companies in some parts of the world, notably Latin America, has recently been reported, and has been attributed partly to recessionary losses abroad and partly to the need of parent companies to rebuild balance sheets and liquidity. However, very few respondents to this survey reported a decrease in their real FDI during the latest five years to 1982 nor did they foresee any during the present five years to 1987 (see page 22). The apparent contradiction is partly explained by the fact that some apparent "disinvestment" proves to have represented *intracompany borrowing* to take advantage of interest rate differentials, particularly borrowing by US head offices from foreign subsidiaries.

- An aspect of FDI which is obvious enough but underscored by this survey is that the influences are different for different types of companies. Those specializing in the *exploitation of natural resources* are obviously drawn to where the resources are. One of the most interesting observations to emerge from interviews was made by an international minerals company which said that it did not have either the financial resources or the technical expertise to offset or ride out the commodities' cycle in metals. It said it was just beginning to try to form a longer 6 to 10 year view, but its present time horizon stretched to 5 years at most. Within that span it tends to invest when metal prices are high and to cut back new spending when metal prices are depressed, in spite of thus adding, together with competitors, to the familiar *commodities' cycle* of overinvestment, glut, underinvestment and scarcity.

The impressionistic view conveyed above is reinforced by the answers of the (admittedly small and statistically insignificant) number of natural resource companies which answered Question 4. Their rate of new FDI rose strongly in the boom period of 1973 to 1977, but has slowed since then and the companies expect flows to slow down still more in the present five years to 1987. Unlike FDI by some other industries, that of natural resources companies does not appear to be countercyclical.

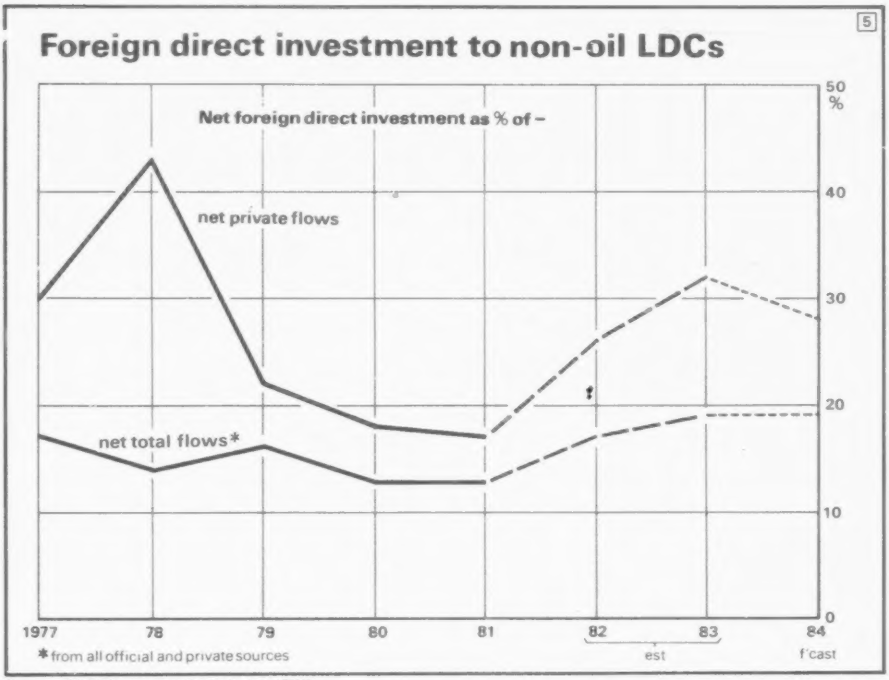
- The answers to Question 9 bring into sharp focus the main *influences on FDI decisions. Access to the host country's domestic market* is by far the most important in the industrialized and developing worlds, followed by *access to regional markets* (for MICs) and avoidance of tarriff barriers (for LDCs). Integration with existing investment is also an important influence on new FDI in the MICs, but less so in the LDCs. Changing industrial structure, and slower growth of home markets, and the avoidance of nontariff barriers to trade follow. For an impression of our respondents' views of the *changing climate for investment*, both by region and industry, see answers to Question 10.

- The factors which do not influence FDI, or hardly so, are as interesting as those that do. Political stability and labor cost advantage in host countries were ranked by our respondents very low among the influences on FDI decisions; even inducements offered by host countries are rated as marginal, underscoring the point that realistically promising opportunities attract investment themselves. The relative unimportance attached to political stability and labor cost advantage is another contradiction of perceived wisdom. The influence of wide fluctuations in exchange rates and interest rates also appears to be less than often believed, subject to the qualifications already mentioned (Questions 13 and 14).

- Increasing emphasis is being placed on *joint ventures*, especially by American companies, and on full acquisitions of foreign companies, especially by European companies in the United States (Question 18).

- Over the past decade the foreign subsidiaries of international companies have been required to stand ever more on their own feet. This is clearly shown in the answers to Question 19 (although it is fair to note that critics accuse international companies of more rhetoric than reality on this score). Since 1973, there has been less reliance on financing provided by parent companies and more on the *retained earnings of subsidiaries, debt, and equity issues in the host countries and debt issues in world markets* (mostly Euromarkets). Interviews reinforce the impression that there has been a relative shift, also, toward more debt and less equity financing of subsidiaries. However, where finance is raised by debt issues by the host country on world markets the impact on the balance of payments of host countries is not clear-cut. Unlike dividend earnings, which tend to rise when business is good, the interest on external debt capital represents a fixed element in the host country's balance of payments in good times and bad. Indeed, it can impose a rising cost, as in the recent past when the price of money rose steeply while world output and trade stagnated. It does not follow, however, that externally held equity is less burdensome for the host country's balance of payments in all cases. This is especially true when international companies aim for a short payback period for recouping their initial investment—and the survey yielded some evidence to suggest that the target payback period was shortening (Question 16). During such a period bunched dividends or remitted profits can make a large if temporary dent on the host country's balance of payments to the extent that there are no impediments to the outflow of remittances from the host country.

- Many companies interviewed said that they detected a tendency towards more realistic and therefore *improved relations* between host countries and international investing companies. The frequency with which the subject was brought up by executives who were being interviewed indicated a continuing sensitivity or at least awareness of the public relations of FDI in the broadest sense, meaning relations with host country governments as well as media.


Foreign direct investment to non-oil LDCs

Source: OECD Economic Outlook, July 1983

Recommendation

If the present survey has any recommendation to make, it is to suggest greater cooperation between international companies, national governments and international agencies to contribute to a prompter, more uniform and simpler reporting of FDI flows and stocks. The need for *quicker and better* information has long been recognized and pursued with new vigor in the international banking field, and similar improvements might usefully be made in the case of direct investment. The *difficulties are real and considerable.* "Salient Features and Trends in Foreign Direct Investment", published by the UN Centre on Transnational Corporations in 1983, contains a full annex on the problems of FDI data compilation. It says:

> "Disparities among countries concerning definitions, coverage and methods of compilation of data on FDI place severe constraints on efforts to collect, compare and analyze flows and stocks of such investment at the international level. Moreover, data are lacking in a few developed and a large number of developing countries".

It then goes on for four pages to explain those difficulties, and to explain its own definitions and methods of compilation and comparison, which are not in all respects the same as those used elsewhere. If FDI is indeed to become a more important component in world capital flows, we suggest an improvement in statistical information will be essential.

The need for an improvement in reporting of international direct investment is thrown into especially sharp relief by Table 3 which appears to show, for most years, the net outflow of direct investment off the earth's face already referred to. The reason for the bewildering picture shown seems to lie mainly in a blurring of the distinction between investment and financial flows meaning, in plain language, between money destined for investment in new plant and machinery, or the acquisition, creation or enlargement of a business abroad, and the movement of temporarily idle cash balances to best advantage within international companies.

Another possible explanation is that earnings retained by affiliates may sometimes be recorded as outflows by parent companies, and recorded as such in the balance of payments statistics of the parent companies' home countries, while not being recorded as inflows by the subsidiaries or their host countries.

The result, whatever the explanations, is to make much data on international direct investment meaningless, even to statisticians. The objective should be to make them intelligible for those who make and influence policy, not least international companies themselves.

Table 3

Net FDI flows

$ billions

	U.S.	W. Europe	Japan	LDCs
1960	-2.6	-0.3	—	n.a.
61	-2.3	+0.1	—	n.a.
62	-2.5	0	—	n.a.
63	-3.3	+0.4	—	n.a.
64	-3.4	+0.8	—	n.a.
65	-4.6	+0.7	—	n.a.
66	-5.0	+1.0	—	n.a.
67	-4.1	+0.7	—	n.a.
68	-4.5	0	-0.1	n.a.
69	-4.7	+0.1	-0.1	n.a.
1970	-6.1	+0.5	-0.3	n.a.
71	-7.3	+0.4	-0.3	n.a.
72	-6.8	+0.4	-0.6	n.a.
73	-8.6	-0.3	-1.9	+4.2
74	-4.3	+0.6	-1.8	+5.3
75	-11.6	-0.9	-1.5	+5.3
76	-7.3	-4.4	-1.9	+5.0
77	-7.9	-2.0	-1.6	+5.4
78	-8.5	-3.4	-2.4	+7.3
79	-14.6	-8.3	-2.9	+8.9
80	-5.6	-6.7	-2.1	+10.1
81	+12.6	-24.0	-4.7	+13.9
82	+12.2	-13.0	-4.9	+11.4

Sources: UN Centre for Transnational Corporations to 1979; OECD 1980-81. Japanese net flows less than $100 million until 1968. Net FDI flows of developing countries are not available on the same basis, but are drawn for 1973-1982 from the IMF annual report, 1983 (p.33)

ANALYSIS OF RESPONSES

SAMPLE

This report is based on written answers to a questionnaire by 52 major international corporations in the leading industrial countries and on subsequent interviews with some of them.

Only large international corporations were approached. As foreign investment is known to be carried out principally by large corporations, and as the companies we approached are all leading international investors it is reasonable to suppose that our respondents account, between them, for a significant proportion of total foreign investment worldwide.

Our respondents (excluding financial corporations) had aggregate assets of more than $400 billion and sales of over $550 billion in 1981. The average foreign to total sales ratio (excluding intracompany sales) was 47 per cent, the median being 45 per cent. We estimate that the foreign assets of our respondents are probably in the range of $200-$250 billion. Although not strictly comparable, the total stock of foreign direct investment, worldwide, is estimated at between $500 billion and $550 billion.

Twenty-nine per cent of the respondents said that foreign sales

Number of companies in sample:

Chemicals	7
Food (Including Trading)	5
Motor Vehicles & Allied	5
Electronic, Appliances	3
Office Equipment, Computers, Telecommunications	3
Pharmaceuticals, Cosmetics, Soap	3
Extractive Industries	3
Metal Refining	3
Building Materials	2
Measuring & Scientific Equipment	2
Beverages	4
Financial, mineral and other	12

More attractive outlook

The World Bank's Development Report, 1983 on the outlook as follows:

"Some of the expansion in bank lending over the past decade substituted for private direct investment. This trend was encouraged by the relatively low interest rates through most of the 1970s and by the restrictions host countries placed on direct investments. The restrictions were often a reaction to past experiences of investments that were unnecessarily subsidized or were seen as having been inconsistent with development objectives. For multinational firms, it was often easy to substitute debt for equity."

"The outlook for direct investment has become more attractive recently, since the cost of borrowing has risen and an understanding has been reached between investors and some host governments. Moreover, the outflows related to direct investment—in the form of profit remittances—are directly dependent on the success of the enterprise, and there is more flexibility as to timing. With the prospects for bank lending more constrained, direct investment may contribute a greater share of the capital flows to developing countries. However, the scope for substitution is limited to the private sector; direct investment cannot be used to finance most development infrastructure."

exceeded 60 per cent of their total sales. Twenty-three per cent said that foreign sales represented between 40 and 60 per cent of total sales whereas for 40 per cent of the respondents this percentage was less than 40.

The manufacturing sector accounted for 77 per cent of our sample; 48 per cent manufactured durable goods and 29 per cent consumer goods. Fifteen per cent of our respondents were financial institutions while the rest came from a variety of other sectors.

Our respondents came from 12 countries. About one third were from the United States, one third from Europe and one third from Japan and other parts of the world.

Except where otherwise indicated a large majority of respondents answered the questions. However, the statistical results are not to be interpreted as more precise than the statements in the text of the preceding section and the comments attached to the following tables.

Trends in foreign investment

1. *During the world recession of recent years, has your company's foreign direct investment: increased substantially, increased somewhat, remained about the same, decreased somewhat, decreased substantially?*

Respondents' view of FDI by their company—

per cent

	All respondents	Respondents from manufacturing sector	
		American	European
Increased substantially	44	44	36
Increased somewhat	29	22	43
Remained about the same	23	28	21
Decreased somewhat	2	6	0
Decreased substantially	2	0	0
	100	100	100

2. *During this same period, do you believe that foreign direct investment by other companies in your industry has:*

—and by their industry

per cent

	All respondents	Respondents from	
		US	Europe
Increased substantially	28	24	22
Increased somewhat	38	29	57
Remained about the same	22	29	14
Decreased somewhat	12	18	7
Decreased substantially	0	0	0
	100	100	100

While respondents believe that their own company's foreign investment has grown faster than that of their industry, two-thirds believe that their industry's FDI has increased "substantially" or "somewhat", at a time when aggregate levels of *domestic output* and especially investment have been flat or falling in nearly all of the parent countries.

3. FDI in the recession

In most industries, foreign direct investment seems to have increased despite the world recession. What do you believe to be the main reasons for this?

The major reasons suggested by respondents (ranked by the frequency with which a particular factor was mentioned) were as follows:

1. The momentum of investment plans and protection of existing markets
2. Intensified search for lower-cost sources of production
3. Diversification, both of market risk and currency risk; with some emphasizing foreign investment as a means of overcoming difficulties in pricing exports at times of large exchange rate fluctuations
4. Growth of various forms of protection, notably local content requirements
5. Faster growth or greater profitability of overseas markets
6. Investment in anticipation of an economic recovery
7. Technical progress and application of new technology
8. More receptive attitude of LDCs
9. "The difficulty of divesting in a recession".
10. "The strong dollar", making FDI more attractive for some US corporations

4. Looking to 1987

Please estimate the change in your company's real, or expected real, foreign direct investment (that is, adjusted for inflation and exchange rate changes as far as possible) for the three five-year periods shown below. (Check one box in each column).

Changes in FDI 1973-1987

per cent

	1973-77	1978-82	1983-87
Increase of 50% or more	*31*	*36*	*9*
Increase of 25% to 49%	*18*	*20*	*20*
Increase of 10% to 24%	*31*	*24*	*39*
Increase of less than 10%	*10*	*10*	*17*
No increase or decrease	*4*	*6*	*7*
Decrease of less than 10%	*2*	*2*	*7*
Decrease of 10% to 24%	*2*	*2*	*2*
Decrease of 25% to 49%	*0*	*0*	*0*
Decrease of 50% or more	*2*	*0*	*0*
	100	*100*	*100*

A deceleration from recent very high growth rates is expected in the next few years. But only four companies of 46 replying expect their FDI to decline in absolute terms. Moreover, it should be recalled that the survey was conducted just before the pointers to the present upturn in the US economy had emerged clearly, and just after the imposition of austerity measures in many LDCs that followed their much-publicized debt-servicing difficulties in mid-1982. As a group, Japanese companies clearly intend to increase their investment at a far more rapid pace than our European or US respondents.

Classifying the results by industry, those expecting an increase of 50 per cent or more were in electronics and office automation equipment; those expecting an increase of 25 to 49 per cent were in chemicals, pharmaceuticals, motor vehicles and scientific instruments; those expecting an increase of 10 to 24 per cent were in food, office equipment, extractive industry and motors; but those expecting an increase of less than 10 per cent also included companies in steel, chemicals, motors, and pharmaceuticals.

5. Foreign sales

Excluding any intracompany sales, approximately what percentage of your company's 1982 total sales were foreign subsidiary sales?

47% (average)

The median figure was 45%; the maximum was 97% and the minimum for an industrial company, was 10%.

6. Geographical distribution of new investments

For each group of countries, please indicate the change, or expected change, in your company's foreign direct investment for the three five-year periods below by writing in "more" for a pronounced increase, "less" for a pronounced decrease and "none" for little or no change.

The table on the following page shows that within the slower growth expected in FDI in 1983-87, the following broad trends may be distinguished: the high proportion expecting to invest "more" in Asian NICs; the sharp fall in the proportion expecting to invest "more" in Latin American NICs (but note also the low proportion expecting to invest "less" in the region); and the finding that investment plans in non-oil LDCs other than NICs seem to have suffered less than might have been expected.

Classifying the results by country of respondent:

(a) Japanese respondents are relatively more expansionary in all areas—all expect a pronounced increase in their investment in other industrial economies and none of them expect to invest "less" in any region;

(b) US corporations remain somewhat more expansionary than their European counterparts among our respondents, with a large majority still planning for a pronounced increase in their investment in industrial countries (compared with only a minority of Europeans expecting such an increase);

(c) European corporations appear particularly gloomy about South American NICs, with only one major corporation expecting a "pronounced increase" in its investment there, compared with six American companies;

(d) Companies in all regions appear to have maintained their plans for further investment in nonoil LDCs better than might have been expected—only two industrial corporations said they expected a

FDI Flows by regions

per cent

Flows into:	1973-77			1978-82			1983-87		
	More	**No change**	**Less**	**More**	**No change**	**Less**	**More**	**No change**	**Less**
Mature industrialized countries (MICs)	*74*	*20*	*6*	*84*	*8*	*8*	*65*	*26*	*9*
European newer industrialized countries (NICs): Greece, Israel, Portugal, Turkey, Yugoslavia	*19*	*77*	*4*	*18*	*78*	*4*	*13*	*78*	*9*
S.E. Asian NICs: Hong Kong, Philippines, Singapore, South Korea	*45*	*49*	*6*	*49*	*47*	*4*	*43*	*53*	*4*
South American NICs: Argentina, Brazil, Mexico, Uruguay	*60*	*38*	*2*	*59*	*35*	*6*	*22*	*67*	*11*
Oil-exporting countries	*34*	*60*	*6*	*31*	*63*	*6*	*24*	*72*	*4*
Non-oil exporting less developed countries (LDCs)	*26*	*70*	*4*	*31*	*65*	*4*	*22*	*71*	*7*

"pronounced decrease" in their investments in this group of countries—one European and one Canadian; and while most respondents expect "no change", nine are still planning on a "pronounced increase".

7. Geographical distribution of assets

Please indicate the approximate percentage of your company's total assets in each group of countries at the end of each of the years shown below.

FDI assets by region-summary

All respondents less banks

	1972	1977	1982	1987
Home country	*60.9*	*57.1*	*56.9*	*55.1*
MICs	*32.1*	*32.1*	*32.6*	*34.6*
European NICs	*0.8*	*1.0*	*0.8*	*1.0*
S.E. Asian NICs	*0.6*	*0.8*	*1.3*	*1.5*
South American NICs	*2.7*	*3.7*	*4.4*	*4.3*
Oil-exporting countries	*0.6*	*1.4*	*1.6*	*1.7*
Non-oil exporting LDCs	*2.3*	*2.6*	*2.4*	*1.9*
	100	*100*	*100*	*100*

The results underline the concentration of assets in the mature industrial economies and no far-reaching changes in the existing distribution of assets are contemplated. However, it should be borne in mind that if we are right in our estimate that our respondents manage almost half of the total outstanding stock of direct investment worldwide, even a one percent shift in the distribution would represent a significant sum, especially if switched to or from poorer regions.

Our US respondents have kept the proportion of their assets held at home remarkably steady, at about two-thirds of total assets on average—and no change is expected on balance in this ratio between 1972 and 1987. (Going through the individual responses, few US corporations expect any increase in the proportion of their assets held overseas in the next five years—though again, this is not a true guide to new investment flows, for various reasons, and especially because those that *do* expect a shift may be among those who expect also to invest large amounts).

FDI assets by region-detail

All respondents less banks

Per cent of respondents' total assets held in:

The home country	**1972**	**1977**	**1982**	**1987**
American	*68*	*64*	*67*	*68*
European	*38*	*35*	*32*	*34*
Canadian	*64*	*57*	*49*	*47*
Asian	*90*	*90*	*82*	*74*
The home country and other MICs				
American	*94*	*90*	*91*	*91*
European	*86*	*85*	*84*	*84*
Canadian	*97*	*91*	*92*	*92*
Asian	*99*	*97*	*95*	*93*
European NICs				
American	*0.3*	*0.3*	*0.3*	*0.4*
European	*2.6*	*2.8*	*2.7*	*3.0*
Canadian	*0.0*	*0.3*	*0.0*	*0.0*
Asian	*0.0*	*0.0*	*0.0*	*0.0*
S.E. Asian NICs				
American	*0.8*	*0.8*	*1.6*	*1.8*
European	*1.0*	*1.2*	*1.4*	*1.6*
Canadian	*0.0*	*0.2*	*0.2*	*0.2*
Asian	*0.5*	*0.7*	*1.5*	*2.0*
South American NICs				
American	*3.3*	*4.5*	*5.8*	*5.5*
European	*3.6*	*4.6*	*5.3*	*5.8*
Canadian	*1.3*	*1.8*	*1.8*	*1.8*
Asian	*0.5*	*0.3*	*0.3*	*0.7*
Oil-exporting countries				
American	*0.3*	*0.4*	*0.4*	*0.3*
European	*1.7*	*1.2*	*1.3*	*1.4*
Canadian	*0.2*	*4.0*	*4.8*	*4.7*
Asian	*0.0*	*1.3*	*2.5*	*3.0*
Non-oil exporting LDCs				
American	*1.2*	*1.5*	*1.4*	*1.1*
European	*5.3*	*5.0*	*5.6*	*4.0*
Canadian	*2.0*	*2.5*	*1.3*	*1.2*
Asian	*0.0*	*1.0*	*1.3*	*1.3*

European, Canadian and Asian companies on average reduced the proportion of assets located in the home country between 1972 and 1982, but only the Japanese expect to reduce this much further in the next few years.

Respondents from all regions have held on average more than 80 per cent of their assets in industrialized economies—and all except the Europeans have held 90 per cent or more in such areas (the home country and other MICs). No group (not even the Japanese) expect to effect a large change in this distribution to 1987. This data, accordingly, suggests though it clearly does not prove that a net increase in direct investment in the developing countries must come largely from their share of an increase in worldwide investment, rather than a large change in the distribution of investment in their favor.

With respect to the developing countries themselves, no large changes are expected, on average, by our respondents—though of course the figures refer to very large and heterogeneous groups of countries and therefore hold no message for an individual economy. Perhaps the main feature is the relatively rapid growth expected by the Asian (almost exclusively Japanese) companies in most regions of the world—albeit from a low level; another feature is that no net reduction in the proportion of assets held in Latin America by nonfinancial corporations is expected, despite the caution expressed about the region by many corporations.

Classifying the results by industry, the companies that have reduced the share of the home country in their total assets in the ten years to 1982 are mainly in high technology, motors and allied industries. In general durable goods manufacturers redistributed their assets away from non oil LDCs to the MICs.

8. The geographical distribution of assets, pre- and post-tax profits, 1972-1987

Although the proportion of assets employed in home countries has remained steady or declined, the contribution of the home country to profits (pre and posttax) increased in the ten years to 1982. (US industrial corporations reported an especially sharp change. In 1976, a majority of US corporations reported that the profit contribution of foreign operations was larger than the proportion of assets employed abroad, whereas by 1982 all but one reported the opposite—a greater relative profit contribution by the United States.) True, as several pointed out, comparability is rendered particularly

The geographical distribution of assets and profits, 1972-1987*

REGION	1972			1977			1982			1987		
	ASSETS	PRETAX PROFITS	POSTTAX PROFITS	ASSETS	PRETAX PROFITS	POSTTAX PROFITS	ASSETS	PRETAX PROFITS	POSTTAX PROFITS	ASSETS	PRETAX PROFITS	POSTTAX PROFITS
Home	62.5	63.3	59.8	57.8	66.3	64.4	56.1	66.8	64.4	54.7	60.1	58.5
Mics	31.1	26.9	30.4	31.8	24.8	26.1	33.3	19.8	19.0	35.1	30.2	31.7
Euro-nics	0.7	0.3	0.4	0.9	0.2	0.3	0.8	0.3	0.5	0.9	0.3	0.3
S. E. Asian Nics	0.6	0.4	0.5	0.8	0.9	0.8	1.5	0.8	0.7	1.7	1.9	1.4
S. Amer. Nics	2.4	2.2	2.8	3.4	3.3	2.9	4.3	2.4	1.6	4.0	3.7	4.4
Oil Exporters	0.6	3.0	2.9	1.4	2.0	1.9	1.6	0.7	0.4	1.7	1.2	1.0
Non-oil Ldcs	2.1	3.9	3.5	2.6	2.5	3.0	2.5	2.7	4.6	1.9	2.3	2.9

*The percentage of the sample responding to this question ranged from 42 per cent for some time periods to 70 per cent for others.

hazardous by changes in accounting conventions, differing ways of treating exchange rate gains and profits, the use of "assets" rather than net investment, and by the fact that several corporations were making large worldwide losses in 1982. Nevertheless, we gained the impression that if allowance could be made for such factors, a real change was taking place in relative profitability and thus in attitudes to foreign investment, notably by US corporations.

Depressed economic conditions, especially in Europe, together with the effects of large medium-term exchange rate movements (both on balance sheet and P&L accounts) and changes in the financing pattern were the most frequently mentioned causes of the volatility of the profit contribution of various regions. Investment in LDCs had suffered from the absence of a sufficiently large market to reap scale economies (in all but a few large LDCs). Where profits were high in LDCs, these were frequently attributed to protection against imports, as well as the rapid growth of the markets concerned.

To quote from some replies:

> "The US is the most profitable market primarily because of efficiencies based on volume. Investment abroad is importantly motivated by desire to participate in high growth markets but earnings suffer from lack of volume, excessive regulations and frequently highly competitive markets. Also higher capital costs where local financing is incurred".
>
> "Generally profit margins tend to be lower in Europe and substantially higher in non-MICs. These differences reflect such factors as the attitude of governments to profits, the rate of underlying economic growth, the influence of trade unions and the extent and sophistication of competition."
>
> "Rates of return on investment in the mining industry fluctuate markedly with metal prices. Hence the distribution of assets and profits in percentage terms will vary depending on relative prices at any point in the business cycle. Movements in exchange rates since initial investments were made have often altered returns, expressed in a single currency. This problem is compounded where assets have been revalued in line with domestic rather than international replacement costs."

9. Main influences on FDI decisions

Listed below are possible influences on foreign direct investment. Please rank the six *most important to your company's* new *foreign direct investment in industrial countries and in less developed countries, in both 1970 and in 1983, by writing the number "1" for the most important factor, "2" for the second most important factor, and so on.*

per cent of respondents mentioning a factor in their "top three"

	Reasons for investment in:			
	Industrial Countries		Less Developed Countries	
	1970	1983	1970	1983
Access to host country's domestic market	89	67	82	87
Access to markets in host country's region	41	37	29	34
Avoidance of existing or anticipated tariff barriers	24	16	51	43
Avoidance of existing or anticipated nontariff trade barriers	13	18	29	28
Integration with your company's existing investment	26	37	4	17
Changes in your industry's structure	20	22	11	9
Slower growth of home market	17	18	11	11
Access to raw materials	13	10	13	11
Inducements offered by host country	11	12	16	13
Integration with other companies' investment	4	8	4	4
Comparative labor cost advantages	4	6	11	13
Comparative material cost advantages	4	6	2	4

	Industrial Countries		Less Developed Countries	
	1970	1983	1970	1983
Shifts of political and social stability	*2*	*8*	*9*	*8*
Tax advantages	*6*	*4*	*7*	*0*
Market presence	*6*	*5*	*3*	*0*
Distribution of risk	*0*	*5*	*0*	*3*
Return on investment in R&D	*3*	*3*	*3*	*3*
Development of local market	*3*	*3*	*3*	*0*
Aquisition opportunities	*3*	*3*	*0*	*0*
Exchange rate movements on *siting* (not financing) investment	*0*	*2*	*0*	*0*

Throughout, the dominant motive for foreign investment is seen as the need to gain access to the host country's domestic market and, the second most important influence was access to the regional market (in the case of investment in developed countries and avoidance of tariff barriers for investment in LDCs.) However, some companies commented that their investments in some markets had reached maturity. In the case of LDCs, higher risk and lower-than-expected growth rates were beginning to offset the desire to gain access to new markets. (Generally, we had the impression that in most companies, but *by no means all*, investment was increasingly of a "consolidation", or even "defensive" variety).

Important secondary influences derive from the desire to avoid or preempt tariff barriers (especially by US corporations in 1970, referring possibly to investment in the European Community ahead of its enlargement in 1973). Avoiding nontariff barriers to trade had become a more important motive by 1983 than earlier.

The Americans in particular placed more weight on "integration with company's existing investment" as an influence in 1983 than in 1970. This was regarded partly as a natural stage in the development of FDI— in the 1970s, many companies had only recently begun to invest on a large scale overseas, often initially in marketing and distribution facilities, whereas by 1983 most of the corporations had widespread mature investments in many countries, and complementarity of investment and the effects on their worldwide competitive position was clearly more important. But partly this too reflects the trend towards "consolidation".

European companies placed more weight in 1983 than in 1970 on "changes in the industry's structure" and "slower growth of the home market"—reflections perhaps of the greater impact of the two oil shocks in Europe than the USA and of the spread of gloomier views about the longer-term future for European economies.

"Tax advantages" and "inducements offered by the host country" were regarded as unimportant influences on investment decisions, though some companies stressed that specific inducements could, on occasion, tip the balance of a decision in favor of investment in a particular country if all other conditions were satisfactory—which was, however, rare.

Contrary to widespread popular impression, most companies are very little influenced by access to "cheap labor" or "cheap raw materials". Comparative labor cost or material cost advantages were not mentioned by high technology industries, chemical companies, food and drink companies, electrical companies or pharmaceutical companies. They were not a consideration even for those companies making labor-intensive, low value-added bulk products for the retail trade (such as soap, detergents, surgical dressings etc.). Often these companies had production facilities in dozens of countries. But the dominant consideration, again, was whether the local market could support an economical level of production. The idea of using LDCs as exporting bases was not attractive to most companies.

The only exceptions to this general rule were some companies in the motor vehicle and allied industries.

10. The changing climate for FDI

(a) *In which* geographical areas *has the climate for foreign direct investment either improved or deteriorated in the past five to ten years? Please list the areas below, along with your views, as to the main reasons for the improvement or deterioration.*

Areas in which the climate has improved	**Reasons cited**
Far East/Japan	*government liberalization of rules and regulations of FDI*

	stable and fast growing markets
	growing market for financial services
	increased product competitiveness
South East Asia	*improved investment climate/open door policies by area governments*
	improved economic and industrial infrastructure
	more sophisticated politicians, officials and financial community
European NICs Spain	*prospect or actuality of EEC membership*
	government liberalization of investment rules
Oil Exporting Countries Saudi Arabia	*government investment incentives*
	improving infrastructure
	increased purchasing power since oil price increases
United States	*relaxing government attitudes toward anti-trust enforcement*
	relative deterioration in the rest of the world
	renewed strength of oil & gas exploration
	improved social climate-resurgence of work ethic
	liberalization of banking regulations

Areas in which climate has deteriorated	**Reasons cited**
Europe	*market saturation*
	effect of global recession
	increasing labor costs
	EEC regulations limiting management decisions
	non-tariff trade barriers
	erosion of EEC cooperation
	decreasing flexibility in decision making due to government regulations

Latin/South America	*increased government controls* *arbitrary government intervention* *nationalism*
Canada	*failure to distinguish between ownership & control* *canadianization (by a Canadian firm)*
Africa	*deterioration of economic and political stability* *"unsafe"*
Nigeria	*increased local shareholdings*

In general, there was far more complaint about deterioration, than satisfaction with improvement. Seventy five per cent of the companies responding to this question complained about Latin and South America, with the majority of those being American companies. Almost fifty percent of the companies (nearly seventy-five percent of Americans) said that conditions in Europe have deteriorated.

The Far East received by far the most positive "votes", followed closely by the United States, with seventy percent and forty percent respectively, with the Americans being more positive than the Europeans about the Far East. Australia received about as many positive as negative votes.

(b) *Similarly, in which* industries *has the climate for foreign direct investment either improved or deteriorated in the past five to ten years? Please list the industries below, along with your views, as to the main reasons for the improvement or deterioration.*

Industries in which climate has improved	**Reasons Cited**
Electronics, computers, telecommunications, defense	*increased public and private demand* *cost curve dynamics, technological development, social changes*

Energy & resource exploration	*search for lower cost sources*
Financial & other professional services	*general worldwide trend away from industry towards the service sector* *liberalized banking environment* *internationalization of travel*
High quality consumer goods	*increasing disposable incomes world-wide*
Export manufacture	*less developed countries' growing need for foreign exchange*
Heavy electrical equipment (in LDCs only)	*drive towards modernization of energy capacity*
Automotive industry (LCDs and Euro-NICs)	*government encouragement of auto investment*

Industries in which climate has deteriorated	**Reasons Cited**
Heavy industry (replies referred to steel, electrical equipment, petro-chemicals, shipbuilding, automobile manufacture):	*overcapacity, protectionism, government supported competition, competition from NICs and LDCs, high energy consumption; Japanese inroads in steel and auto manufacture; performance requirements*
Retail trades	*government regulations and control*
Pharmaceuticals	*protectionism, adverse advertising campaign*

11. Political risk

Does your company systematically monitor political risk and the possibilities of economic policy changes in countries where it has or is contemplating foreign direct investments?

86% YES 14% NO

Political risk assessment provides both a short term and a long term potential benefit. In the short term, it provides at best an early warning system for troubled areas. In the long term, most corporations view political risk assessment as an integral part of their long range planning and strategies.

Those companies answering "no" to this question usually undertook risk analysis prior to a particular investment decision.

12. Hedging strategies

What are the main ways in which your company protects itself against political risk and possibilities of economic policy changes?

Many corporations laid the main emphasis on structuring their global strategy to reduce risk; others talked more about their efforts to maintain good relations with host governments and the local community.

Many keep their enterprises spread globally to diversify risks, as a seemingly separate strategy from merely seeking markets. Some avoid investments in regions outside the developed market economies. Others, mainly producers of consumer goods, maintain a low profile in foreign countries, and avoid contact with the government on anything but a commercial level. Several mentioned that they minimize equity exposure and require their subsidiaries to finance themselves, either with local debt instruments and/or equity financing. Some have disinvested in risky areas. Quite a few mentioned using political risk insurance available through government agencies (like the Overseas Private Investment Corporation) to cover themselves. Most use senior management of subsidiaries to provide information on the local economy and political trends.

Many employ nationals as managers. Several mentioned they maintain active public relations programs with the governments and that they try to be good "citizens" or "part of the local economy". Others emphasized that they try to pursue investments which are seen by the government and nationals as beneficial to the country. Joint ventures were seen as providing on way to "involve local support" and sharing risks.

Two perform "regular security surveys of local business entities and senior management residences".

13. The influence of exchange rates

What, in your view, have been the main effects of wide fluctuations of exchange rates *on the volume, direction and nature of foreign direct investment flows?*

Many answered that while exchange rate fluctuations are considered when various projects are analyzed, they are only one of many factors which are evaluated and by themselves often have little impact.

Most respondents maintained that the main effect of foreign exchange movements is not on the direction or level of FDI, but rather on its financing.

Some however, said that the uncertainty created by wide movements caused reluctance to contemplate large projects in countries affected by such swings.

One corporation pointed out that short term swings are relatively unimportant in influencing flows, but that long term trends which are out of line with economic fundamentals affect future decisions about investments in particular countries. Another company commented that while in its opinion currency swings had not affected FDI per se, they had affected flows primarily of a portfolio nature in several instances. Fluctuations were also said to have some effect on the timing of investment projects, with one company saying that it had delayed and cancelled some projects because of currency problems.

14. The influence of interest rates

Similarly, what have been the main effects of wide fluctuations of interest rates *on the volume, direction and nature of foreign direct investment flows?*

Again, most corporations said that the fluctuations in rates had had little impact on the direction or volume of their investment flows. More companies expressed worries over the effect of high real rates, not the fluctuations of nominal rates of interest. Some indicated that they were more selective in making investments, and that fluctuating rates had induced them to invest in the "safer" MIC economies. A few respondents, notably banks, suggested that over the longer term, fluctuations would have a negative impact on FDI.

One company, echoed by four or five others, said that wide interest rate movements (and high real rates) had had a significant impact on the level and direction of FDI. Their comments:

> "Interest rate volatility has had a significant impact on investment flows. The high interest rates in the developed economies have led to reductions in investment volume, and correspondingly the direction and nature of investments are being altered."

> "Because new direct investments are normally highly leveraged (for many reasons, such as: dividend limitations, tax considerations and availability of debt), the increased interest costs associated with high interest rates have raised the threshold for new investments becoming feasible. Moreover as worldwide growth has declined and political/

economic risks have increased, the impact of added interest expense reduces the risk adjusted potential for new enterprises in many areas and industries (e.g., Latin America and Africa's primary industries)."

"The one possible exception would be the electronics industries in the newly developed countries of the Far East (e.g. Taiwan, Singapore and South Korea). In this area more stable political climates exist, associated with policies to reduce return volatility of new investment projects (e.g., South Korea's legislated reduction of interest rates)."

15. From study to execution

Approximately what percentage of foreign direct investments seriously studied by your company are actually made?

58% (mean)
90% (maximum)
10% (minimum)

Corporations in capital-intensive industries like chemicals and heavy electrical equipment tend to make a high proportion of investments studied. Those with low ratios tend to be in food processing, service industries, or in mining.

During the last five to ten years, 26% reported that the proportion of investments studied and then actually made had decreased, 15% that it had increased:

Increased:	15%
Decreased:	26%
Remained about the same:	59%

Of those corporations reporting a decrease in the number of projects actually executed most ascribed the decrease to uncertainty over future business opportunities. Others commented that they were investigating larger projects than they had in the past, of which fewer were implemented. A few companies said they had found no suitable new investments. One corporation indicated that it had almost fulfilled its global corporate strategy and was therefore slowing down the rate of new investments. Joint ventures were also mentioned as a reason for the decline in the number of projects actually executed.

16. Target payback periods

Please indicate, where applicable, your company's target payback period (in years) for new foreign direct investment in industrial countries and in less developed countries both in 1970 and in 1983.

Industries compared

years

	Industrial Countries		Less Developed Countries	
	1970	1983	1970	1983
Mining	7.0	6.0	6.0	5.0
Manufacturing	4.5	4.5	4.4	4.5
Trading	4.3	3.0	2.5	2.0
Finance	5.0	4.8	4.0	4.2
OVERALL	5.3	4.7	4.2	3.9

Several were sceptical of the value of such "targets" or the more popular "rate of return" concept and did not respond. Some suggested that a "post mortem" analysis would reveal a very different story.

A higher proportion of US firms responded to this question. The answers for manufacturing are nearly constant. In all other industries, the typical response calls for a shorter payback period for LDCs compared to ICs and for 1983 compared to 1970, indicating possibly a shift in the distribution of investment to areas promising a quick return.

US companies consistently looked for a much shorter payback than Europeans (there is no indication whether they achieved it or not).

US	*4.5*	*4.0*	*4.0*	*3.5*
Europe	*5.4*	*5.5*	*5.0*	*5.6*

The main reasons given for the shorter payback period looked for now than in 1970 were: the increased cost of capital, greater political and financial risks, and the need for earnings (poor financial position of the parent company).

17. Plant versus R&D

During the last five to ten years, has there been a change in the ratio between investment in plant versus investment in the application of management and technology within the total of your company's direct foreign investment? Please answer below for both industrial countries and less developed countries.

	Industrial Countries	**Less Developed Countries**
	per cent	
Proportion of investment in plant has increased	*19*	*18*
Proportion of investment in application of management and technology has increased	*39*	*26*
No major changes in proportions	*42*	*56*

In recent years increasing emphasis has been placed on R&D, and this, together with increased demand for local manufacturing and development activities, has led to an increase in the proportion of investment devoted to the application of management and technology. However, most companies consider the two activites as complementary, and report no major change in the proportions.

To quote from a number of replies:

> "The increase in investments related to the application of management and technology is a natural result of the renewed focus of the group on research and development."
>
> "Both industrial and less developed countries have increased their demand for local manufacturing and development activities. For the most part, meeting these demands has required a transfer of technology because investment in plant had been made previously."
>
> "There has been a tendency throughout the world for the traditional straight equity sale to give way to more complex arrangements. Investors are rewarded partly through management contracts of various types rather than a straight share of the profits. More is written about a few atypical contracts, however, than about most investments which have followed traditional forms" (a mining company).

18. Forms of investment

What changes in emphasis have there been, or do you anticipate, away from some forms of foreign direct investment and toward others? Please write "more," or "less" or "none" for each type of investment for both industrial countries (ICs) and less developed countries (LDCs) for each five-year period shown below.

Forms of investment

per cent of all respondents

		Sole investment in new ventures ("green fields")	Full acquisition of businesses abroad	Portfolio control of businesses abroad	Joint ventures
			1973-77		
ICs	More	35	38	14	29
	Less	7	5	10	7
LDCs	More	26	14	12	38
	Less	17	10	7	7
			1978-83		
ICs	More	33	43	23	39
	Less	18	9	9	14
LDCs	More	30	16	14	36
	Less	21	16	9	11
			1983-87		
ICs	More	27	38	25	43
	Less	32	23	8	18
LDCs	More	30	10	15	46
	Less	28	8	5	7

Within the move away from green field investments towards joint ventures and acquisitions, American companies expect to rely heavily on joint ventures both in LDCs and in industrial countries; Europeans expect to rely on full acquisition of businesses abroad in industrial countries (mainly in the United States) and joint ventures in LDCs; while Japanese companies still appear to place emphasis on sole investments in new ventures.

19. Which way for FDI finance?

What changes have there been, or do you anticipate, in methods of financing new or expanded foreign direct investment? Please write "more", "less" or "none" for each method listed for each five-year period shown below. (All respondents)

	1973-77		**1978-82**		**1983-87**	
	More	Less	More	Less	More	Less
Retained earnings of parent company	43	21	26	40	28	42
Retained earnings of foreign subsidiaries	49	7	52	12	67	7
Issue of new equity in parent company	12	5	17	7	19	14
Issue of new equity in host country	12	7	21	5	45	5
Debt issues in parent country	29	2	38	12	29	24
Debt issues in host country	39	12	55	10	57	12
Debt issues in world markets	32	12	50	5	55	2

Generally, the companies hope to rely much less on retained earnings of parent companies as a source of FDI financing, doubtless reflecting pressures on parent company earnings and balance sheets. Instead, they hope to use retained earnings of foreign subsidiaries, debt issues in world markets and host countries, and equity issues in the host countries.

Most US companies expect to rely more on debt issues in world markets, whereas European and Asian companies expect to rely more on issuing new equity in host countries, presumably issues to finance acquisitions in the United States. All however, expect foreign subsidiaries increasingly to finance their own expansion internally, though whether such expectations will be realized is another question.

Publications

Policy Statements:

Measures to Combat Inflation
The Group of Thirty

The Problem of Exchange Rates
The Group of Thirty

The World Economy Between Recession and Recovery
H. Johannes Witteveen

Study Group Reports:

Toward a Less Unstable International Monetary System
The Reserve Assets Study Group

Foreign Exchange Markets Under Floating Rates
The Exchange Markets Participants' Study Group

Balance-of-Payments Problems of Developing Countries
The Capital Movements and the Growth of International Indebtedness Study Group

The Outlook for International Bank Lending
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Reserve Currencies in Transition
Robert V. Roosa, et al.

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How Bankers See the World Financial Market
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Risks in International Bank Lending
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Richard Dale

The Future of the International Oil Market
Edwin A. Deagle, Jr.

The IMF and the Private Markets
Committee on International Banking

Commercial Banks and the Restructuring of Cross Border Debt
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Occasional Papers:

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Group of Thirty

Economic cooperation from the inside

by

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Economic cooperation from the inside

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Francois-Xavier Ortoli, former President of the Commission of the European Communities

Emile van Lennep, Secretary General, the Organization for Economic Cooperation and Development

Alan Whittome, Director, European Department, the International Monetary Fund

N.B. Several of the above now hold other positions in the private or public sector, which are not shown.

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Introduction

This study evolved from worries expressed last year by members of the Group of Thirty about the state of international cooperation on general economic and monetary issues. Political, nationalistic and personality overtones make this a complicated and nonrewarding subject for open debate. So we asked leading figures in current and recent past negotiations to talk to us one by one on a confidential basis, the understanding being that their views would not be identifiable in the subsequent report. While recording our appreciation of the time they have given to this study, we feel their willingness to do so reflects their concern and encourages us to believe the project has an important message.

On the other hand, we should not give the impression our survey is exhaustive. We have not attempted to cover all types of international negotiations that involve economic issues. Though trade and energy issues are necessarily referred to, we did not interview negotiators in such specialized areas. And we have concentrated on American and European views since these have mostly polarized the debates at a macroeconomic level.

A standard set of questions was used as the framework for each interview. We report in the next section what we believe is a fair representation of the answers to these questions. But the interviews ranged more widely, as they were intended to do, so that our conclusions are by no means drawn exclusively from the questionnaire responses.

Many readers will dispute some interpretations of past events, and some perceptions of current developments, reported here. Many of the episodes referred to remain controversial. The purpose of the exercise is not to rewrite history or to pretend to come to a "true" view of the present state of cooperation, but to report as fairly as possible what we have been told. The usefulness of such reporting rests on the assumption that the perceptions of people actively engaged in international negotiations today may have a force of their own; and that it is better to be aware of these perceptions, especially if they are not in accordance with one's own views, than to take refuge in abstractions or hazy expressions of "international goodwill."

Closing of ranks

From the outset it was clear the timing of our interviews, most of which were carried out between January and September, 1983, was particularly sensitive. Had we made our investigation a year earlier, our panelists would almost certainly have been even gloomier about cooperation than they were and probably there would have been no doubt that it had deteriorated over time. But the closing of ranks in the face of the threat to the entire financial system from the debt problems of Mexico and other Latin American countries has here and there struck a new note of optimism, particularly among those now holding positions of responsibility — indeed, to some it reflects a strength in cooperation beyond that ever seen in the past.

Paul Volcker referred to this in a speech on April 28, 1983:

> "I was asked recently, as part of a survey of monetary officials, whether I sensed that international economic cooperation had in fact declined over the past 10 or 15 years. What people mean by cooperation is highly subjective, and I doubt my answer was enlightening to the inquirers. But the question intrigues me, and I have tried it out on my colleagues at home and abroad. What surprised me — and may console you — is that in my informal survey a number of officials actually on the firing line throughout this past decade, in the United States and Europe, responded quite positively. In the face of severe challenge from technological change, from economic and political "shocks," and from the sense of more difficult and complicated domestic problems, they were inclined to see *more* willingness to consult in a meaningful way. They felt we are now more open and candid with each other, that we exchange more information — and collect more of it together — and that we are at least as willing as before to recognize joint problems and consider joint solutions. Implicit or explicit in that view was the idea that mutual recognition of the desirability, where possible, of looking to 'market' solutions can itself be a constructive act of cooperation."

This optimism needs to be qualified. First, there is the obvious point that the debt problems of the developing countries have by no means been solved by the rescue packages, any of which could come unstuck at any moment. Cooperation was being tested, rather than proved, as we did our interviews. Second, it is open to question whether these rescue operations, even if they are successful in their immediate purpose, will seem as good in retrospect. Might they not, like some similar operations 10 - 20 years ago, be only postponing the inevitable and increasing the eventual cost?

Only time will tell. Depressingly, however, postwar economic history relates that it has required a perception of crisis, a pragmatic judgment that quick action is needed, to obtain a major cooperative response. Even the

Bretton Woods agreement on fixed-but-adjustable exchange rates is perceived as having required wartime stimulus. As their examples of successful cooperation after Bretton Woods, several of those interviewed chose the central bankers' support operations for serling in the mid-1960s, yet added ruefully that, looking back, it would probably have been better if sterling had been devalued sooner rather than later. By their very nature, rescues indicate that a dangerous situation has been allowed to develop and sometimes the damage has already gone too far.

The art of the possible

The cautionary tale told, we still see the coming-together over the debt problem as a foundation for something promising. And we think our investigation indicates that it might be best to build on what looks possible and what impossible.

Some of the factors that are perceived to have been working against international cooperation may be only temporary, some are more permanent. In the first category comes the doctrinal policy of some of today's big powers that demands minimal government interference and full play for the markets. However, this attitude has already been softened by experience and, anyway, governments change. Perhaps in the same category, though less clearly so, is the confused state of economic theory — the economics profession got bad marks in our interviews. The lack of understanding of key issues — such as the relationship between massive budget deficits and interest rates — makes it hard to develop any political consensus.

A permanent change with important implications is the decline in the weight of the American economy in the system — a continuing refrain in the comments made to us, especially by Europeans and Japanese, but also by some Americans. As one put it:

> "The decline of the United States from being 'hors de concours' to being 'primus inter pares' is itself destabilizing. An oligopoly is inherently harder to handle than a monopoly, if the monopolist is benign"...

The comment, of course, is not implying cooperation has declined, but rather that it is never called for if one power has dominant control of the system. The reason everyone backs away from any thought of re-writing Bretton Woods is not that three or four times as many countries would be involved today, but because the 1944 so-called "agreement" was, in fact, an American-written rulebook for running a dollar system, even if a lot of British ideas had gone into it — and even then it needed to be helped by wartime urgency.

The amount of cooperation actually called for in adhering to the

Bretton Woods rulebook can also lead to a semantic discussion. Although perhaps the most fundamental issue raised, in different ways, throughout the interviews is whether any significant improvement in international monetary and economic cooperation can be expected in the absence of a return to a framework for greater exchange stability, this probably reflects the widespread disenchantment with the system of floating exchange rates rather than a judgment on cooperation. Floating has not removed the need for cooperation, as some of its advocates had claimed. Yet in the view of most of our respondents it has made cooperation more difficult. Under fixed rates, there are sanctions for not obeying the rules — you get flung out of the club. There are no such sanctions in a floating world and what are the rules anyway?

As a former European prime minister said, under the previous system, "there was a code of good conduct." This has not been developed under floating. The attempt in the mid-1970s to establish "guidelines" for floating was widely regarded as premature. Under floating, some exchange rates have been out of line with underlying competitive positions for much longer periods than had been expected. This instability has tended to ratchet-up the level of protectionism and of inflationary pressures (or of unemployment, if inflationary pressures are offset by tighter monetary policies) in the global economy.

The mechanism by which an international view on a country's policies (and on the consistency of the policies of the major countries) is developed, is widely perceived to be less effective than it was under Bretton Woods. As the major governments do not either need to go to the IMF for approval of a parity change or to obtain parliamentary approval at home for it, the possibility for other countries or international organizations to influence national policies has obviously been much reduced. As a practical matter, it is much harder to make governments aware of the international dimension to policy in the absence of discrete parity changes.

Gradual evolution

Very few contemplate wide-ranging reform of either the exchange rate system or the functions of the multinational institutions. Memories of failed or misplaced attempts going back to the 1960s inhibit any ambition to try again.

Wrangles over the launch of the IMF's SDR that took up the time and energy of the officials in the 1960s at the cost of more pressing demands, the theoretical debate of the Committee of Twenty that got nowhere in the early 1970s, the sudden demise of the IMF's hard-fought plan for a substitution account: enough is enough. And while the institutions do not escape criticism, again realism dictates that only minor modifications and gradual evolution are feasible.

Most of our respondents rate the IMF the most important of the international institutions and strongly favor a boost in its resources. Of course, they had the rescue packages for Mexico, Brazil and other major debtors in mind and might not have been as enthusiastic before August, 1982. Even so, there is a body of opinion that regrets the IMF's shift, as it is seen, towards an aid institution and feels it has sloughed off too easily responsibility for monitoring the new exchange rate system, which would necessitate having more influence on the big powers' economic policies. But again the realists are in the majority. "International institutions," as one said, "provide a useful talking shop, but they can only really influence our policies if they have money to lend and we need it."

So reform — if that is the right word — is not going to come by way of the institutions, according to our panel. It will be a political process which the officials can help along but not cook up solely among themselves. Our panel takes a somewhat cynical view of summits of heads of state, but nevertheless sees them as the most promising forum for setting new trends.

A new beginning?

Our study has detected a growing sign of willingness in the past few months to give external factors a higher priority. In particular, the Reagan Administration is taking a more accommodating stance. Criticisms made quite frequently by our respondents were to the effect that "the international monetary system changes every time there is a new Under Secretary for Monetary Affairs at the American Treasury" and "each new Administration tends to sell policies that have been formulated to meet domestic political and ideological interests to the rest of the world." The present Administration is seen to have been particularly culpable, but several people commented on the inexperience of officials brought in to most Administrations — "it's a two-year learning process."

So the shock of the LDC debt crisis has coincided with — or brought about — a more helpful American attitude internationally, at the same time as the last lingering illusions that floating rates would remove the need for explicit cooperation have evaporated. We identify two areas where, with a little push, international cooperation may now be strengthened.

The first — the international regulation of banking and financial markets — may seem a little mundane, but could have far-reaching consequences. A consensus reached by the Basle committee on bank regulation — recently revised — has never been put fully into practice. For instance, even the agreement to require consolidated accounts from banks has not yet reached legal status in West Germany. Now at least some new ideas are afoot, which could conceivably bring in the IMF, as well as the BIS.

More fundamental would be some conscious rule-making for the system, which, said a key policyholder, "I would not rule out." What might that involve? It would, presumably, entail some rules about intervention in the markets by the big three or four countries (principally the United States, West Germany and Japan) — perhaps target zones of the "wrong" rates rather than the "right" ones. At least one European would like to see the ECU involved — "fixed-but-adjustable parities between the ECU, dollar and yen." More crucially, it would involve some voluntary coordination of monetary policies — a big step forward in a world where, up to now, coordination has occurred only under duress.

Economic cooperation from the inside

Answers to questions

1. Do you think that international economic and monetary cooperation between major countries has deteriorated and if so how is this evident?

A majority said that international cooperation had deteriorated in recent years. "It is now much more defensive," a former US official said; "there is less consensus on monetary policy, major differences in domestic policies and unrealistic exchange rates". As one European put it:

> "All the things that link countries together — trade, exchange rates, interest rates, payments balances — have shown much greater volatility and are under growing pressure. The fall-off in the rate of economic growth is partly a consequence of this lack of cooperation".

Some participants contrasted the response to the first oil shock in 1972-73 with that to the second in 1979-80. After the first, there was an attempt to forge an international consensus on recycling and though the response may have been inadequate, steps were taken to enlarge the capacity of the IMF and other international institutions to help countries affected by the steep rise in their oil bills. There was also agreement to try to avoid beggar-my-neighbor trade policies. In contrast after the second oil shock, governments concentrated on fighting inflation and inward-looking policies were more prevalent. Each country went its own way. All the governments that had come to power in recent years were less "internationalist" than their predecessors.

Failure to bring about more coordination of economic policies in forums like the IMF's interim committee or summits was noted too. Europeans grumbled that they had been unable to persuade the United States to modify its policies on budget deficits and interest rates. "Cooperation is as bad as it has been at any time in the past quarter of a century", said one.

At the outset of this survey some contrasted cooperation among central banks with that among governments. To quote one American observer, who like some others defined his terms carefully:

> "Understanding 'cooperation' to denote a sense of shared objectives and un-

> derstood differences, and the politics as well as the mechanisms involved, central bank cooperation has become better and cooperation among finance ministers substantially worse".

Whether or not central banks coordinated among themselves, one former European prime minister blamed the central bankers for not monitoring the international banking system, and for not warning their governments of the dangers of allowing the debts of developing countries to snowball: "Central bankers should have tried harder to understand what was going on."

Many participants viewed the 1950s and early 1960s as the high watermark of cooperation. As one put it, the Fund managed the fixed-rate system and the OECD provided an effective vehicle for the coordination of macroeconomic policies in a fixed-exchange-rate world. Underlying the relative smoothness of monetary cooperation was the stability of the dollar itself. Conscious cooperation was unnecessary because a cooperative outcome was taken for granted. The need for cooperation was felt only when that framework began to disintegrate.

Opinions differed as to when that disintegration started. Some put it in the mid-1960s, when it became clear that the United States was not willing to allow its policies to be constrained by the operation of the gold-exchange standard, declining either to tighten its monetary policy sufficiently to validate the pattern of fixed rates or to devalue the dollar. Efforts to shore up that earlier system started in the early 1960s with the arrangements to defend the dollar and continued with the struggle to maintain sterling at $2.80 and the search for a new reserve asset from 1965 — evidence of the extent of cooperation or of the growing strains on a doomed system, according to taste.

More conventionally, most dated the decline from August 1971, when President Nixon not only brought the curtain down on Bretton Woods by suspending the convertibility of the dollar into gold but also imposed the temporary import surcharge, introducing a new nationalistic flavor to US international monetary policy. Others pointed out, however, that with the agreement on a new set of parities in December 1971, "we thought we were moving to a managed exchange rate system", and that it was only with the move to generalized floating in March 1973 that the effort to maintain a formal framework of exchange rates ended.

Some, however, said the decline began only in 1981, when the Reagan Administration took office. Many showed extreme frustration with the Reaganite policies in 1981-82 — notably the volatility of US monetary policy, the indifference displayed with regard to its effects on the outside world (and, in the long run, for the United States), plus the bad-mouthing of the IMF and World Bank. "Until January, 1981", said one former US official, "I don't think that cooperation did decline. There was less cooperation on the system, but not less on substance".

Others said it was too easy to blame the Reagan Administration. Under Carter and Nixon too, there had been a strong tendency in the United States to ignore other countries' problems or misinterpret them, and a lack of judgment in public speeches, together with a bewildering turnover of policies, each of which was presented as the solution to all difficulties, adding to the general confusion and unnecessarily aggravating natural differences of perspective, intellectual tradition and national interest.

Not unqualified gloom

A few respondents maintained that although some forms of institutionalized cooperation had suffered, there had been no deterioration in:

(a) "Fire brigade" operations, or specific acts of cooperation, to shore up the system — examples included the dollar support package in November, 1978 and the more recent LDC debt problem. "When action is needed quickly", said a central banker, "you will get major cooperation — probably more than in earlier years".

(b) Cooperation in a limited area of policy, where the benefits to all plainly exceed the costs (as in agreements to reduce energy consumption or on export credits).

Several respondents, including some of those who maintained that cooperation had not declined, remarked that it had never been as close as it may seem in retrospect (e.g. the French devalued in 1957 without any prior warning; Germany upvalued the mark in March 1961 without consulting the IMF or the EC; Germany floated the DM without prior warning in May 1971 and finally the US suspended gold convertibility in August 1971 again without warning). Equally, the outlook was better than might appear. Among the reasons given were the following:

(a) countries' understanding of each others' economies had much improved, partly as a result of the regular analyses conducted over the years by the leading international organizations, and partly because of more intensive discussion in the past ten years of general economic policy as well as exchange rates, especially in the EC;

(b) in spite of everything, trade had continued to grow until 1982, as had the "openness" of the main economies;

(c) there had been agreement on the need to fight inflation, and the better harmonization of inflation rates around a lower level of inflation that has resulted may usher in a new epoch of better price stability. This could provide a good basis for working again towards close cooperation, "with the goal of making monetary policy less volatile and the international monetary system more stable";

(d) the Reagan Administration had received a series of big shocks (after two years of ~~giving shocks to~~ everybody else) and had swung round 180 degrees on the attitudes that had previously given so much offence, notably towards the international organizations. "Americans have shown a capacity to become more pragmatic when the problems burn their own fingers".

2. If you agree that cooperation has deteriorated, do you think this is because:

(a) the problems to be solved have changed in nature; or

(b) the machinery for cooperation is less effective than it was; or

(c) governments have more limited control because of political and other constraints; or

(d) there are disagreements as to the appropriate economic policy response?

Nearly all our respondents who think international cooperation has deteriorated said one reason was the confusion today over the appropriate response to growing economic problems and the uncertainty this causes — i.e. (d) in our questionnaire. Many of them think this — plus the general deterioration of economic conditions — the most important reason, though several also believe governments' control over their own economies has lessened, which also weakens cooperation: "You can't coordinate what you don't control", as one central banker put it. Everyone, whatever their views on cooperation, considers problems have changed in nature — which is fairly self-evident. Surprisingly few, however, think the machinery for cooperation is less effective than it was, though the few who do have a clear explanation.

(a) the problems to be solved have changed in nature

There was overwhelming agreement that problems have changed, and a number of areas were highlighted: floating exchange rates, capital movements, energy, inflation, bulging budget deficits and trade policies.

To many but not all central bankers, floating was the most important change and a bad one in the context of this study. Advocates of floating had said it removes the need for cooperation, but clearly that is wrong and strong interdependence remains. "Floating rates work against cooperation and over time encourage nationalism", said a European central banker. The other big financial change mentioned by several respondents was the growth of the Eurocurrency market in the past 10 years. "We have not yet sufficiently grasped the effects of this growth or of floating exchange rates," said one official.

To some, however, monetary problems such as exchange rate swings are not the fundamental worry: "their role is exaggerated by the politicians who are always looking for scapegoats". Trading problems are dominating because economies are much more open. So there is a new sensitivity to competitive pressures, both at the level of the firm and whole sectors. Because of competition from the NICs (newly-industrializing countries), structural changes are needed in European industries, but the response has been more and more EC intervention, which creates permanent contravention of market rules. "Politicians should take the lead in explaining the need for changes. They haven't even got people used to the competitiveness of Japan, let alone the NICs".

To others the main bugbear is still inflation. As one official put it:

> "Inflation at the rate we've been seeing has not been a common feature of the world — it is a relatively recent phenomenon."

(b) the machinery for cooperation is less effective than it was

Most said the machinery is in place and potentially no less effective than it was. One view was that the machinery (or the mechanism) was "incomparably better" today, as compared with the period before 1973.

Some said that the management of one or another of the major international institutions could have been more effective (see answers to Question 6); and a minority implied that the machinery itself was less effective. A central banker observed:

> "A lot of machinery disappeared with the breakdown of Bretton Woods; it had sanctions, notably going to the IMF for support. True, a good deal survives but with floating rates it is not the same".

The machinery was also seen as having failed to adapt adequately to changing circumstances, particularly to balance-of-payment imbalances after the two oil shocks.

> "So long as bank recycling worked, nobody considered it necessary to restore the institutional framework — the only progress made was in the EC. But now this is changing and the climate again becoming conducive to international cooperation".

The reference was to the recent agreement to provide the IMF with more resources. This had come about, explained a European official, not only because of the many problems in commercial banking, but also because the United States was having second thoughts.

> "It could not get its budget-mix right, so used monetary policy, which pushed up interest rates and overvalued the dollar. It now wants to get the dollar down but needs cooperation from other countries to achieve that. It's the old story of a reserve currency country being unable to devalue if others lower interest rates and so on".

Some international civil servants expressed their concern that the machinery has moved away from meetings of officials to meetings of ministers and of heads of state. It was logical and perhaps unavoidable, but, in their view, made for less effectiveness because these meetings are not backed up with adequate staff work nor is there a proper follow-through.

(c) governments have more limited control because of political and other constraints

Several of our respondents did not consider governments have more limited control than they had. "Don't think they ever had all that much, given the fact we live in a trading world", was a typical comment. But they were in a minority. Others thought it obvious that governments have less control than they did in the 1960s because of the oil price increase, huge capital movements, (e.g. the flood to America as a result of high interest rates since 1980), operations of multilateral corporations and international bank lending. One finance ministry official thought the question was a bit skewed: as he saw it, the environment in which governments have to operate has left them with less stability in which to do whatever they were doing about their own economies. Others mentioned the increasing complexity of managing public-sector deficits and government spending. "It is quite a different world, struggling with giant public-sector deficits", said one official.

(d) disagreements as to the appropriate economic policy response

As we have already reported, this was seen as the most important of the causes listed, though it seemed to be contradicted by the view, also taken by many, that the big countries have never been as unanimous in their policy aims as in the past few years. Except for France's dash for growth in 1981, all had pursued resolutely anti-inflationary policies for the past four years. How could they disagree when they were all set on similar courses?

Part of the explanation for this apparent paradox is that countries have pursued these anti-inflationary policies by means of very different "mixes" of monetary and fiscal policy, and it is these differences that have accounted for much of the disputes over policy — notably many Europeans' criticism of US budget deficits which in their view have kept US interest rates at such high levels. The refusal of the US administration to modify these policies, or even apparently to listen to European criticism, was the most frequently-mentioned specific irritant in recent international monetary discussion.

Another part of the explanation is that while major countries have made the control of inflation their top priority, this by no means reflects a consensus of view within each country, least of all among economists. On the contrary, both political and economic opinions were seen as increasingly polarized. At any moment, therefore, the chances are that before long a number of governments will come to power with completely different notions from their predecessors of what should be done internally — and by extension, internationally. As a former senior international civil servant commented:

> "Such disputes and the accompanying uncertainty can only add to the general confusion and scepticism about the feasibility of international cooperation: there is always a tendency in such situations to fall back on simplistic solutions".

Yet another reason for the apparent contradiction is that, as one former European minister emphasized, while countries' policies may be set on similar courses, this does not necessarily imply any convergence in the underlying structures of their economies or in their relative tolerance of unemployment or inflation. Tight monetary policies have put a lid on inflation, but the domestic conflicts that generated pressures for accommodating policies remain — and their strength differs greatly among the leading countries.

Probably most participants would agree with the American who said that "people are very confused and want to go in different directions. If there is no consensus about what you want to do in the international area, people don't want ever to undertake a major negotiation. They shy away from it, and then by definition domestic considerations take priority".

3. Has the conflict increased between internal and external objectives? If so, why do you think this is?

A majority of our respondents thought the conflict had increased. Most of those who did not, felt it was impossible to generalize; the situation varied from country to country. Only one suggested that the conflict has decreased. Several emphasized that the generalized floating of exchange rates had not eliminated the conflict, as some of its advocates had predicted in their initial enthusiasm for it.

Why had the conflict increased? Here are some of the replies:

(a) Internal objectives are clearly much more important at times of massive unemployment. But an expansionary policy may be in conflict with the need for external balance.

(b) The conflict has increased — or has appeared to — largely because of monetarism. "The more countries look inwards, with policies directed to internal objectives, the less they care about external factors", said a central bank official.

(c) Another conflict resulted recently from US high interest rates during a period of stagnation. In several countries, such as Germany and Britain, interest rate policy has had to be oriented to the dollar exchange rate, in conflict with domestic requirements.

(d) "Without the discipline of the Bretton Woods system, external objectives are relegated to second place", was the quick response from a former central banker. Another former central banker, however, said that floating imposed as much discipline as fixed rates.

(e) A somewhat different view from an international civil servant: "Because of growing interdependence, the margin of maneuver for pursuing domestic objectives has been reduced for everybody, including the United States. Events in one part of the world spark repercussions far away; for example, the Polish debt crisis precipitated the Latin American crisis".

France was often cited as a case among the big powers recently in showing the continuing conflict between internal and external objectives in having to try to keep up with the DM within the EMS. For smaller countries too there is more conflict because they perceive it as in their own interest to peg their exchange rates. Others said that even big countries had faced greater conflicts recently, partly because more of them had currencies that were now widely held abroad as reserve currencies.

There were some wry comments from Europeans along these lines:

> "The Americans' problem has always been that they never saw the need to reconcile internal and external objectives. That is exactly how the conflict expressed itself at the end of the 1960s, with the Germans howling their heads off that their internal and external objectives were being brought into conflict by the behavior of the Americans".

A more hopeful note from another participant:

> "Most American administrations start off not believing that there is an external dimension to what they were doing: they all actually came to tend to believe there is. The present one seems to be no exception".

The general view was that internal problems have been acute recently and governments have concentrated on them, but their resolution has been made more difficult by growing interdependence and the influence of intellectual theories saying that all countries need to do is to get their domestic policies right. This means there is a growing temptation to use external instruments to achieve domestic objectives, especially to use competitive devaluations as, for instance, Sweden has done.

4. From your own experience, could you instance (a) a particularly successful piece of international cooperation and (b) a particularly unsuccessful one? Do you draw any general conclusions from your answers?

Respondents interpreted this question in somewhat different ways — some emphasizing the fact of reaching agreement, others judging by results. None of the examples of cooperation given were generally judged successful in terms both of prior intention and results. The SDR — "half success and half failure" — was mentioned as "the only piece of international reform which came about without any pressure of crisis."

Five cited the Bonn summit of 1978, which agreed to put the locomotive theory into practice, as an example of successful cooperation; many cited it as an example of unsuccessful cooperation. To some it seemed enough that an agreement had been reached which had seemed a sensible move at the time, even if, in hindsight, it was not. "The Bonn summit was successful not necessarily in its outcome but it seemed to be a step in the right direction at the time," observed one European official. Another respondent found it very difficult to judge the Bonn summit: "The main objective, as it seemed at the time, was for Germany to do something and such cooperation seemed sensible. What we did not realize was that activity was already picking up in other countries, so we had two or three locomotives. But the outcome was disastrous — not because of the cooperative initiative, but because we misjudged the room there was for stimulation."

The BIS support arrangements for sterling in the 1960s were judged successful by several respondents. But one of them said it should probably be seen also as an example of unsuccessful cooperation since, looking back, it might have been better if sterling had been devalued sooner, "though that would have been a classic example of internal objectives taking precedence." Two chose as successful examples the sterling balance agreements and the follow-up agreements, involving guarantees to sterling holders, backed by a Group of Ten line of credit — "a three-cornered operation," as one of them put it, "involving almost all countries outside Latin America, which let the sterling overhang be run down in a sensible way."

"I could answer EMS to both parts of this question," said one who picked out the EMS — "with all its shortcomings." Some of the more technical achievements, particularly of the IMF, were chosen as successful examples by some respondents and there was no controversy there. Examples included the Jamaica Conference of 1976, which settled the long-standing controversies about the treatment of gold and of floating rates, and produced a corresponding revision of the Fund's Articles; the Witteveen oil facility; and the increase in IMF quotas at the last interim committee meeting.

Others voted for the Basle package for Mexico, and another for "the whole operation which started with Mexico, ran through Toronto and ended in snow in Washington, and included the IMF fix, GAB increase, lashing up Mexico, lashing up Brazil." Two thought the 1974 OECD trade pledge a good piece of cooperation. Two also mentioned the cooperation between the American and German central banks in the autumn of 1978 "during the worst of all dollar crises."

Summits did not come out well. True, two respondents said the Tokyo summit, which concentrated on energy, was an example of good cooperation. But if opinion was split about the Bonn summit, there was no doubt about the Versailles one: that was given the thumbs down by many respondents. The failed attempt at the Puerto Rico summit to set up surveillance for credits to East Europe was one former official's example of unsuccessful cooperation. Another participant dubbed all summit meetings unsuccessful.

The Smithsonian agreement ("which tried to do the impossible"), the Committee of Twenty ("totally unsuccessful," "an enormous sweat that went nowhere") and other efforts to reform the international monetary system were chosen as unsuccessful examples of cooperation by four respondents. Another pointed to the long drawn-out attempt to get the Euromarkets under better control. Two others — both European — cited recent devaluations made without consultation, i.e. the Greek and Swedish ones.

Some drew general conclusions from their answers. "With fixed exchange rates," said a former central banker, "there were rules, civilized ways of altering exchange rates, so the importance of external policy had to be maintained all the time — and that's good housekeeping. With the present system; external policy takes a back seat — and that's bad." Another comment was: "Must have a bunch of strong finance ministers." Three views centered on the need to involve the international institutions or at least strengthen them. "You must build on the international organizations you have got and let them evolve to deal with particular circumstances — keep them with sufficient funds, but not too much money," as one finance ministry official put it.

A former international civil servant said: "The problem of summits is that they keep international institutions out and tend to paper over problems as a result." The view applied to other international meetings also: "If you get ministers of big countries together, there is an overwhelming temptation to overlook real issues and say what others like to hear."

Other participants stressed how much harder it is to get cooperation in general policy than in defined areas. Though one central banker said it was "not impossible to coordinate macroeconomic policies," another was more cautious: "It can't be a one-shot operation, but there are always difficulties with the follow-up and it may not be feasible at all." And an official from a previous US administration was even more gloomy: "It is impossible now to coordinate domestic policies; heads of governments have enough trouble trying to reconcile different interests within their countries."

5. Do you think there is now noticeably less international orientation among (a) central bankers (b) government officials than there was in the days of fixed exchange rates? Has there been less cooperation since floating rates?

Our participants did not think there is less international orientation today among central bankers than there was in the Bretton Woods days, though a few thought this true only recently as a result of the LDC debt crisis. "We need to be all that much closer because there isn't a system," was a comment several others echoed. Another was:

> "Central bankers have withstood better the intellectual challenge to the need for cooperation because: (1) people at the top change more slowly in central banks than in governments and therefore there is more reflection of the older ideas of cooperation; (2) central bankers see the conflict between new ideas and the reality of fluctuating rates more clearly than ministry officials; and (3) their own positions and influence are clearly at stake."

The majority view was that government officials were less internationally oriented than they used to be. Why? One American thought it had nothing to do with floating, which "in the end does the same thing as fixed rates — the discipline of the markets is a discipline on nutty policies and governments." Europeans tended to disagree. One said:

> "The actual degree of integration has outpaced the intellectual capacity to recognize it or understand it, and such understanding is a precondition for the development of a political consensus on what to do about it. We are faced not only with a crisis of economic cooperation and policymaking, but also a crisis of international economic theory."

Was this due to floating? "Yes. In the old days you had to go to parliament and explain why you had devalued, not just say 'It's the markets'."

Another respondent put it this way: "Floating enables governments to escape the need to change policies publicly, so requires no international approval." And yet another: "In recent years, the views of those academics who say you cannot know what the right exchange rate is have had great influence — a theme making it very difficult to discuss anything at all. Yet the yen's rate is crazy."

Other Europeans blamed governments. "It is because of the coincidence of three governments with strong domestic convictions — the Reagan, Thatcher, Mitterrand governments," said one. Five other views were angled specifically on the American government. "The attitude of the United States is all important. If the United States is positive about cooperation, other countries will follow suit. The Reagan administration has been totally negative." But this respondent, like the other four, thought it was not just a Reaganite characteristic. "There has been a tendency before this Administration to ignore other countries and a lack of judgment in public speeches — for instance, Blumenthal on the dollar." Others put it more rudely. 'American administrations are never professional, they're amateurs." However, this was countered by an American view that "the United States is the only country that even thinks about the implications of its actions for the system, or ever takes an internationalist view," and from another: "Serious initiatives which get negotiated seriously do not come from Japan or Britain or France or Germany, partly because of personalities and partly because there isn't sufficient agreement on the substance of the policies." "The Europeans haven't got an idea between them that they can agree on and put collective pressure on us. I must say I am shocked by the Europeans."

6. To what extent does the degree of international cooperation at any given time depend on the personalities of a few key officials?

Nearly all our participants thought personalities were important — many said very important. Former finance ministers or prime ministers were thinking in terms of the top political masters, government officials of the deputy level; some said at both levels. Many said the personalities of central bankers counted for a lot in international forums — Volcker, Richardson, Zijlstra and Leutwiler were among those picked out as notably good. Others stressed the example of political leadership provided by the understanding between Helmut Schmidt and Giscard d'Estaing.

About half those who answered this question mentioned the importance of American figures. As one put it: "It is all very difficult for foreigners if there is no dominant American spokesman." "The quality of US leadership has declined steadily since President Johnson: Reagan has a stronger personality than Carter but understands even less." Several deplored the lack of international orientation of the present Under Secretary for Monetary Affairs at the American Treasury, Mr. Sprinkel.

A few made comments about personalities at the head of the multilateral institutions, making the point that they need to have political weight. "They must have influence in Washington," said a former European finance minister, "or be able to influence enough Europeans to influence the United States." An American observed: "The IMF's Managing Director has to be respected by governments and commercial banks — it's not enough just to give the Fund more money." A former European prime minister put it more strongly: "As the IMF cannot influence the United States, the only substitute is to have great characters to head the institutions."

Against the general trend, a few deplored the cult of personalities; the political environment was more important, they said. These were officials from countries where a strong civil service is traditional.

7. How do you rate the roles that international institutions — IMF, OECD, BIS — have been able to play in international cooperation? How could their contributions be improved?

Comments on this question reflected the widespread view that the political will to use the machinery of cooperation, not the institutions themselves, was the decisive factor. Nevertheless, some respondents said that the institutions could have played a more effective role, within the political boundaries in which they had to function, and two or three respondents were extremely critical indeed. We feel it would be irresponsible to report all the views expressed to us. Nevertheless, in the following summaries we concentrate on the reasonable criticism or qualifications made — taking for granted that all respondents were generally supportive of the international institutions.

The IMF

The Fund was widely held to have had less influence since the advent of floating exchange rates, and never to had had any influence on the United States. Within the limits set by these "facts of life" most respondents said it had been as effective as could have been expected.

Perhaps the most frequent criticism was that in some respects the Fund had "not lived up to what it might have been." Again, this was partly seen as the inevitable result of the political unwillingness to give substance to the provisions of the revised Article IV authorizing the Fund to exercise "firm surveillance" over countries' exchange rate policies. This only made sense if the Fund was allowed to influence policies at their formative state. But at least in the mid-1970s the major countries were not willing to meet regularly with the Managing Director of the Fund. The view was that "We have to see the Fund as a judge" — a view that excluded it from exercising effective influence on the formulation of policies. There was no evidence that the major countries have changed their minds since then.

The Fund's policies were also criticized for their volatility — apparently easing and tightening the policy conditions attached to its lending in an unpredictable way. Once more, this was viewed as perhaps an inevitable consequence of the volatility of US policy. Again, however, several respondents said or implied that the Fund could have tried to withstand these pressures more vigorously. It might have tried harder, some said, to develop an agreed international view of the major problems of the world economy — e.g. in its annual reports:

> "The Fund should always tread close to the margin of what is politically possible," said one.

Several respondents said that the top people in all the international institutions should have political experience and authority, and a feel for the politics as well as the mechanisms involved. When the chips were down, the big issues were settled by a few finance ministers sitting together without advisers, and it was useful if leaders of the international institutions had such political experience.

Some respondents went further. "In the last few years the IMF has rather unimaginatively followed the policies pursued by the major countries."

Others said that the Fund has damaged itself by following unrealistic ideas — as on the Substitution Account ("we all spent a lot of time on it, yet no country ever wanted it — only the Fund staff") and by failing to exercise surveillance. Also:

> "The international situation needs to be explained to the public in plain language, using simple terms. These days one has to try to reach the ordinary educated man. The reports of the IMF are far too theoretical."

A related view was that the Fund had become too much of a development institution, and had not focused enough on the problems of the industrial countries.

> "After all, the Fund is the guardian of the international monetary system and should have lived up to its responsibilities and pressed governments of industrial countries harder. It does first-class staff work but as an institution it does not have much effect on policies."

Article IV was widely regarded as a dead letter, and the attempt in 1974-75 to formulate rules for floating rates premature, though one respondent said that the new article was accurate and relevant. Another retorted that even now, with a growing danger of competitive devaluations, the Fund is not in a position to use its powers under Article IV. But again, at best one could expect only more 'ad hoc,' or 'specific acts of cooperation,' or 'political' cooperation.

It was recognized that the Fund had gained new life in the past few years, and that Mr. de Larosière, the Managing Director, had moved rapidly and courageously to impose the authority of the Fund in gaining the cooperation of commercial banks in the debt crisis. What it had lost in terms of "system management" had been regained in "crisis management."

Comments:

"It takes too much of a one-country-at-a-time view for my taste, but maybe that is inevitable." "The Fund ends up concentrating on things where it is perceived to have a major role."

The OECD

Tributes were paid to the quality of the OECD's economic analysis, and the contribution it had made to better understanding of how the economies of its member countries function, and the interrelationships among them. But its role was widely thought to have been reduced in recent years and, in contrast to that of the Fund, there was little sign as yet of a recovery.

Because it has no money to lend, the OECD has always relied on other means or incentives by which influence could be brought to bear on countries following policies inconsistent with its "internationalist" view of their position and responsibilities. Under Bretton Woods, this was ultimately provided not only by the commitment of most senior policy-makers to the ideal of international cooperation but also by the specific structure of the par-value system. (Indeed, it was not realized in the OECD at the time that success in the movement towards greater flexibility of rates would diminish its role — officials thought they would move to a "managed" exchange rate system).

Under the fixed rate regime, the OECD could analyze the outlook for payments imbalances (and their financing), growth, and employment "with the parameters held in place." If a country was out of line, comments were made, questions raised about the consistency of that country's policies with the "world view" analysis of the secretariat, and often action followed. For instance, following the sterling devaluation of 1967, the WP3 met to hear the UK representative explain the policies the government would follow to make it effective. Other countries with more experience of devaluation than Britain said that these policies would not be enough — and this pressure played a part in Mr. Roy Jenkins' switch to a more deflationary policy.

During this period, the unspoken assumption of fixed exchange rates — which economists were beginning to question — allowed the OECD to mobilize "peer group pressure" on a country out of line, and also gave a central role to the "world view" analysis of the secretariat. Many witnesses told us about the effectiveness of the work of the WP3 in this period. Mr. van Lennep, the present Secretary General, who was then chairman of the WP3, made a habit of writing to finance ministers and central bank governors bringing international considerations to bear on their policies — and they paid attention. The practice died out later. Such discussions became the central focus and vehicle of international policy coordination — while the Fund did the "technical" job of managing the fixed rate system.

But even before the collapse of Bretton Woods, this began to be changed by; (a) the passing of the generation that had run policy in the postwar years — a generation deeply seared by the experience of the 1930s and the lessons drawn from them; (b) the intellectual challenge which gradually replaced the principle that "we're all in the same boat together" with the different principle that "if we all get our policies right at home, the world economy will look after itself" and (c) fundamentally less-manageable economic and political problems, following the end of the golden years of growth, the multiplication of economic issues raised to cabinet-level discussions, and the disillusionment with "fine tuning" and demand management generally.

Increasingly, as officials who attended OECD's meetings could not agree, the focus shifted to ministerial meetings — the Group of Ten, Interim Committee, Group of Five. Meanwhile, the European Community was developing into a focus of regional cooperation — inherently competitive with the OECD/IMF "one world" view — while the NICs were also claiming a place in the system. There were growing problems in gaining agreement on who should be represented at meetings: on the one hand, a smaller group can more easily mobilize "peer group pressure" on a recalcitrant member — on the other, all important interests should be represented, including some smaller countries, which often represent the collective or general interest.

At this stage, according to some observers, the OECD found itself unable to update its intellectual orientation, or develop enough political "feel" and "weight" to establish a role in the new system comparable with that it had played in the old. This failure, as well as institutional rivalries (notably with the EC) prevented it from becoming the secretariat to the summit meetings, which was a logical evolution. Both the OECD and the summits may have lost thereby (though some dismissed the notion that the OECD had any chance of servicing the summits). As a result, the newer structures of cooperation have not been integrated with the older structures, there is no consistent "world view" developed at staff level on which discussions should be based, no adequate preparation and no adequate follow-through:

> "The machinery has evolved in a way that has been destructive of existing institutions, and in a way that is not truly representative. We haven't developed institutions reflecting the 'oligopolistic' power structure of the 1970s-1990s in the place of old US leadership. When we wanted to sell an idea in the old days, we went to Washington and got them to sell it to the others. Now it is much harder."

A list of comments:

a) "The OECD is a great mystery. There is no evidence that it has much impact at all. It is not effective at governmental level — except that some small countries are worried if they get a bad public report. Contact between officials in WP3 does provide a little intellectual lubrication, but OECD is a back-seat driver. However, its able Secretary General has given it a role in the press that another man might not have done".

b) "The OECD has been rather disappointing — it has no real powers but has exercised a restraining influence in holding back protectionism. It has no muscle".

c) "The OECD is valuable as a talking shop, just in keeping industrial countries talking to each other. Because it has no money its main influence was during the fixed rate regime, when it could analyze the outlook for payments imbalances, growth and so on, with the external parameters held in place. It is much harder now for it to be effective with floating and inward-looking policies".

d) "The OECD is much better than the others at economic analysis and presentation, but it is too Keynesian. It does not have enough monetary expertise or knowledge about financial institutions".

e) "The OECD will never regain its old importance because most countries now have better opportunities to meet outside the OECD. Soon it will be nothing more than a meeting place for analysts of the business cycle: it has outlived its usefulness".

The BIS

Both the virtues and the limitations of the "central bankers' club" were mentioned by our respondents. Central bankers have flexibility, because monetary policy can be changed without legislative process; they can move quickly in a "fire brigade" role to raise large sums of money; and above all their deliberations can be kept confidential. On the other hand, often "their hands are tied" — finance and economics ministers, not central bankers, make the strategic decisions. They differ greatly in their degree of independence, though some of the most independent have recently been least innovative. Central bankers have always been conscious of their vulnerability to political and popular criticism. And they have felt the lack of a natural domestic constituency for an "international" view. The answers we received suggested that the cross-currents of the 1970s had highlighted such conflicting aspects of the central bankers' role. In some ways, they were better able to withstand the intellectual challenge of monetarism. But the advent of floating exchange rates tended to reduce their influence. Politicians have criticized them for not monitoring or understanding the international banking system. While they have recently been called upon to mobilize large sums of short-term credit for countries stricken with payments difficulties, shouldn't they have done more to control the mushrooming of the international credit that led to the crisis?

Some quotes:

> "Probably the best of these clubs, within its limits".
> "Its officials were the first to warn officially of the debt problem".
> "It is a Holy-Roman-Empire kind of place for central bankers to meet".

8. Do you favor the strengthening or extension of the multilateral institutions, notably the IMF? If so, in what respects? And do you think such a strengthening to be feasible?

The general view was that the IMF should to be strengthened in terms of resources provided it can make conditionality stick. But there was scepticism about whether its "powers" should be increased. Or, indeed, whether that is feasible. "Only when we have a crisis and we're looking over the edge of an abyss", was the opinion of a former prime minister. Several observed that the IMF does not even use its existing powers.

Two participants said they thought the IMF should borrow from the market. A European central banker said he was against it on the grounds that it would further reduce the liquidity of official claims on the Fund, which he thought was a matter of concern. "If it deteriorates, creditor countries will in time get cold feet. We'll build up big claims on the Fund as part of our reserves; for a central bank it is essential these are liquid and the IMF has to realize this. There is a tendency for the Fund to neglect the importance of this for central banks".

While most participants from the major countries thought the IMF was already expanding in the right direction and all that is needed is to keep it flexible so that it can be continually built on, some views were more visionary. The IMF should think more like a central monetary institution and "not be afraid to talk like one on issues like SDRs and aid-links". More important, "it ought to think more and do more about what is required to make a multicurrency reserve system work. We gave them pointers at Versailles; it could build on these". Another said that it is feasible to strengthen its authority in certain ways, in particular by devising a set of penalties and incentives to persuade countries to go to the Fund at an earlier stage in their payments difficulties.

This view is not inconsistent with that of another respondent formerly close to IMF policymaking, who sees a longer-term need to reform the Fund's structure. "It should be a bank — the whole idea of a 'fund' was only brought in by the Americans to limit their possible exposure, and in fact, the quota limitation is already being eroded". This last reference is to the fact that the IMF now lends up to 450% of a member country's quota under a conditional credit in place of the former 100%. But that 450% figure is only a guideline, not a statutory rule; the IMF executive board is empowered to alter it.

Finally, a key policy maker said he "would not rule out" an attempt to write rules for the system, a process in which the IMF could doubtless play a central role.

With regard to the OECD, a few suggestions for improvement were made. It should have more flexible ways of holding discussions in smaller groups. It should also play a political role as a spokesman for the industrialized countries to the third world and the NICs. A more fundamental suggestion from a European government official was that "if it is really very clever", it should preside over a proper synthesis of Keynesian/Friedmanite principles and their application to a changing world environment. "Where else, on an international scale, could you have discussions on these great issues that divide policy? Not with a lot of LDCs". The role may not seem attractive to people at OECD, who want to strengthen its political prestige and not become "members of a university". Nevertheless, it is an intriguing suggestion, coming from someone who sees the OECD as the "most important international economics institute".

9. Should finance ministers have more frequent meetings? If so, as the Group of Five, the Ten or (bringing in the developing world), the Twenty? Should the IMF and/or OECD be more involved in such meetings?

"For God's sake, no" was a not untypical reaction to the first part of this question. What mattered was the political will to use the meetings constructively, and to divert ministers' attention for a time from purely domestic answers to domestic problems, but respondents differed considerably in their views of the usefulness of the groups and in the extent to which they thought that the IMF and/or OECD could be more involved.

Comments:

> "It is very important to strengthen the Group of Five. I realize this may annoy the OECD, but there it is. The WP3 is too large. We could have more frequent meetings of deputies — we had five in 1981-82, all secret. We normally relied on our own staff work, and can write papers on a personal basis, if necessary".

> "Not meetings, but markets, impose pressure to adjust under Article IV. Surveillance by the Fund needs to be given substance, but it means nothing without a strong G-5 — and that means a bunch of strong finance ministers, including a US spokesman who can speak for the President. Trouble is, there is no respect for each other at present. They can't even keep quiet about the G-5 meetings — a central requirement, otherwise it's all a charade. Unless they can be sure of confidentiality, they will immediately get locked into their negotiating positions — e.g. UK Chancellors are paralyzed by Parliamentary question time" (American observer).

> "There are too many meetings already. We should be much more selective. We must restore the confidentiality of such meetings. The G-5 are the most important — just finance ministers and central bank governors. But it has recently been destroyed by publicity — interviews are given before the participants meet!" (former European prime minister).

> "A good meeting requires agreement on all points before it takes place" (former European prime minister).

> "To hold meetings without results is counterproductive, since they raise doubts that might not have surfaced otherwise. The Interim Committee is useless. The Group of Five is the serious one. OECD could play a role here if it gets a strong political push".

> "The G-5 is the most important of these, but the big countries are not likely to allow the international institutions to play a large role in it. The G-5 is the locus of 'political' or 'ad hoc' cooperation. As the United States is ready for that again, we could even see a move towards an understanding between the US and the EC on target zones for exchange rates. We always wanted the EC to have a common policy with regard to the dollar, but we need US agreement for that".

> "Both the IMF and the OECD should be involved in G-5 meetings, so that they are better prepared and have a better follow-up" (former international financial official).

> "The Group of Ten has worked well; it negotiated SDRs, and had some good discussions — the role of smaller countries is usually constructive, because it is in their interests to get agreement among the major powers".

> "The fact of life is that the G-5 countries are more dominating and unanimous in their objectives than ever before, so it is very important that they should seek to agree on their policies. But you have to be cynical about how much will come out of the experiment of asking the MD of the Fund to attend. It was given to the Fund rather than the OECD because of the more conservative stance of its policies".

> "The Group of Ten has always been awkward. Why should the US go to meetings to be attacked by Belgium and Switzerland?".

> "When the big countries meet alone — e.g. as the G-5 — they very rarely criticize each other, or attempt to formulate a view of the international interest. They are much keener to make trade-offs between each other".

> "If the Group of Five doesn't work, larger groups won't".

> "The trouble is that four out of the Group of Five never take the initiative. France, Britain, Germany and Japan moan all the time about US policies, but they have never come up with a constructive idea and have never put real pressure on the United States. Their behavior is rather childish" (central banker).

> "If you have a lot of international bureaucrats at these meetings, the meetings take on a different function. It is quite useful, however, to have the IMF helping to control the agenda for the G-5" (finance ministry official).

> "Ministers meet far too often — they don't have any time to sit back and think" (former European prime minister).

10. In your judgment, is there evidence that the greater degree of monetary and economic cooperation aimed at within the European Community has had positive results in practice?

There was a striking difference of view between those from countries whose currencies are not members of the EMS, who said the EMS was irrelevant or at best marginally positive, and those from member countries, who were enthusiastic.

Most respondents would probably agree with the international official who said:

> "It is providing a useful test-bed for a managed adjustable peg system, but it could be blown apart, which would give ammunition to those who always said it wouldn't work. It was misguided to try to use fixity to impose greater convergence of policies than was possible. But it has gradually moved to striking a realistic balance between relatively marginal adjustment of national policies with the necessary recognition of reality in terms of adjusting exchange rates".

Another official observed that policies in all member countries now take account of their EMS obligations, and decisions about central rates have become fully collective (i.e. they are decisions of the Council of Ministers, prepared by the Monetary Committee).

It was also said that the Commission is freer to take positions in public about policies of member countries than can the Fund or OECD. But others said that the Commission was generally even worse than the Fund in its absorption with its institutional mysteries, one reason perhaps for the alleged neglect of EC monetary affairs by the Anglo-Saxon press.

11. What place has summitry in international cooperation? How could economic summits of heads of state be made more useful?

Summits were regarded as inevitable but the quality of the input and output as poor. While they could be useful in "setting artificial deadlines" for policy decisions, and "mobilizing domestic support for unpopular policies", they also sometimes delayed decisions that would have been taken at lower levels if people hadn't been able to say "wait for the summit". Some felt they should be institutionalized, with better staff work and papers, and follow-through, but many others said they should be as informal as possible (the ideal being "a quiet weekend chat", which the host country *could* insist on, if it wished) and that they were the place for ideas rather than decisions. For instance, if exchange rates were to be the focus of attempts to coordinate policies better, this involved a mass of issues relating to fiscal and monetary policy which summit meetings were not equipped to settle. Most regretted the blaze of publicity that surrounds them — "ridiculous theatre". However inevitable, that was just one more reason for their inability to serve as useful places for decision-making.

Forums of International Cooperation

There are many established forums for discussing international monetary and economic problems at ministerial and official levels.

In the 1950s and early 1960s the most important discussions on current economic developments generally took place in the OEEC/OECD and the BIS. During the 1960s, the **Group of Ten**, whose members are finance ministers and central bank governors of the major industrial countries, became increasingly important. In 1963 this group — the so-called rich man's club — began to hold regular meetings dealing mainly with international monetary reform thereby treading somewhat on the toes of the executive directors of the IMF.

The Group of Ten went out of favor with the Americans after the ill-fated Smithsonian meeting in December, 1971, which marked the attempt to refix exchange rates that was to fail so quickly: in the early 1970s the IMF's **Committee of Twenty**, deliberating a grand design of international monetary reform, seemed to have taken over from the Group of Ten. But that committee's work was torpedoed by the oil crisis and it had to admit defeat in 1974. However, some of the Group of Ten's former role has been taken over by the IMF's ministerial-level **Interim Committee**, which has 22 members, about half from developing countries, and has met twice a year since October, 1974.

The Group of Ten has also been somewhat eclipsed by a still more exclusive club. The Interim Committee is cumbersome and bargaining is reckoned to be best done within the smallest possible power group. From the time of the 1973 IMF annual meeting in Nairobi, the most important forum has become the **Group of Five**, consisting of finance ministers from the United States, Japan, Britain, France and Germany. This inner group met once again in 1973 after the Nairobi meeting, at the invitation of Giscard d'Estaing (then France's finance minister) and has met frequently since, regularly during IMF meetings but at other times also.

It was from these Group of Five ministerial meetings that the idea of annual **economic summits** evolved, the first being held at Rambouillet in November, 1975, at the invitation of Giscard d'Estaing (by then France's president), when six heads of government met, Italy having been added to the five. Canada has been included too since 1976.

Summits

1. Rambouillet, November 15-17, 1975

Six heads of government (United States, Japan, Britain, France, Germany and Italy) attended. There was a Franco-American agreement on exchange rates. France gave up its insistence that new IMF articles must provide for the eventual reestablishment of fixed parities. The United States agreed that "our monetary authorities will act to counter disorderly market conditions or erratic fluctuations in exchange rates". It subsequently became clear, however, that the United States was taking a narrow interpretation of the clause and had not really committed itself to more forceful intervention in the exchange markets.

2. Puerto Rico, June 27-28, 1976

Canada joined the six, making the first seven-power summit. Criticisms from Italy and Canada about being excluded from Group of Five meetings. The summiteers agreed risks would be taken by the stronger economies in allowing quite high unemployment if that was reckoned necessary to keep prices in check.

3. London, May 7-8, 1977

European community represented for the first time (by Roy Jenkins). President Carter's first overseas visit after his inauguration. The statesmen committed themselves to seek additional resources for the IMF. They also promised to stick to their own growth targets and take action if they began to fall short. But the strong countries (United States, West Germany, Japan) did not promise any specific new stimulatory action.

4. Bonn, July 16-17, 1978

Declaration of the "locomotive theory", with West Germany and Japan becoming the locomotives to help pull up expansion in the industrial world. The West German delegation (led by Helmut Schmidt) indicated that by end-August it would propose legislative measures to add up to 1 percent to GNP. And the Prime Minister of Japan gave assurances that measures would be taken as necessary to achieve Japan's real growth target for fiscal 1978, which was about 1.5 percentage points higher than in the previous year.

5. Tokyo, June 28-29, 1979

Focused on energy, after the second oil shock. Wrangling over oil import ceilings.

6. Venice, June 22-23, 1980

Largely platitudes. Private lending to oil-importing developing countries will need to be supplemented by an expanded role for international institutions, especially the IMF. Continued close cooperation in exchange-market policies so as to avoid disorderly exchange-rate fluctuations. "We will also cooperate with the IMF to achieve more effective surveillance".

7. Ottawa, July 19-21, 1981

Specific issue: American interest rates, which were seen by West European governments as resulting in severe pressure on their currencies in relation to the dollar, and also as representing a major obstacle to recovery from the world recession.

8. Versailles, June 5-6, 1982

Great expectations were built up before this summit that some coordinated action would be taken by the western leaders to counter both recession and exchange-rate volatility. The communiqué was bland. The Americans promised to "counter disorderly conditions" in the exchange markets, but they had said that before. All that was new from the Americans was a promise of an international study on intervention.

9. Williamsburg, May 28-30, 1983

The vague reassurances about cooperation made at Versailles were repeated. Coordinated intervention in the foreign exchanges was promised where "it is agreed that such intervention would be helpful". This left the main thrust of intervention still confined to countering disorderly markets. In a concession to the French, finance ministers were told to define, in consultation with the IMF's managing director, conditions for improving the international monetary system and to consider the possibility, "in due course", of a high-level international monetary conference. There was also talk about a full-fledged negotiating round in the GATT.

IMF (International Monetary Fund)

Established at the Bretton Woods (New Hampshire) conference in 1944, the IMF was envisaged as an organisation that would ensure a stable world financial system and monitor a system of fixed exchange rates. The World Bank was set up at the same time to help in development assistance.

Both are specialized agencies of the United Nations.

Nearly 40 years ago, it was never conceived that gold or the dollar would be challenged as reserve assets. The founders of the IMF — 45 nations, led by the United States and Britain — were concerned to prevent a repetition of the beggar-my-neighbor trade policies of the 1930s, when countries resorted to competitive currency depreciations in their efforts to solve unemployment problems. Each IMF member, therefore, was obliged to establish a par value for its currency in terms of gold and change it only after having secured IMF approval, given only if the country's balance of payments was in "fundamental disequilibrium." Meantime, the IMF stood ready to lend, under certain conditions, to member countries in temporary balance-of-payments deficits. Clearly the IMF did not intend exchange-rate adjustments to be taken lightly.

The world's monetary system has changed radically since then. The system of fixed exchange rates has long broken down and gold has disappeared from the center of the stage. When the system of pegged rates finally collapsed in 1973, it looked as if the IMF was out of a job. And so it might have been had it not been for the shocks produced by OPEC's oil price rise in October, 1973. The IMF quickly saw the need to recycle funds from the surplus countries to the deficit countries to help them meet the high cost of their oil imports, and it launched new mechanisms to do this — the so-called oil and Witteveen facilities.

Since then, increasing calls have been made on the IMF's resources by cash-starved and debt-ridden countries, most recently by major Latin-American countries. The IMF is lending more than ever before to more countries and it now has 146 members. It is thus increasing its influence on the domestic economic policies of member states, since countries can only borrow from it — beyond comparatively small amounts — if they agree to implement approved programs of economic reform. And commercial banks, forced to reschedule their huge loans to many developing countries unable to meet their obligations, are also insisting these debtor countries accept IMF programs before they can hope for much-needed new bank credit. Indeed, banks are increasingly reluctant to take any sovereign risk unless the IMF is monitoring the country's economic progress. So the IMF has now a central role to play in keeping the world economy going and preventing the financial system from breaking down. But it can only do this if it has enough money to make conditional loans.

For most of its lifetime the IMF has worried about a shortage of resources. It relies basically on its quota subscriptions; these now total about $94 billion, but only about half are in currencies that are acceptable internationally and which therefore the IMF can on-lend. More than 20 years ago, the IMF reflected what would happen if its largest member, the United States, sought to borrow heavily from it; in November, 1961, for example, the United States had a potential right to borrow $5.8 billion from the IMF, but the IMF's holdings of usable currencies at the time amounted to only about $1.5 billion.

So the **GAB (General Arrangements to Borrow)** came into being in 1962 after a series of involved negotiations. Ten countries (the United States, West Germany, France, Britain, Italy, Japan, Canada, the Netherlands, Belgium and Sweden) agreed to stand ready to lend $6 billion between them in their national currencies to the IMF, for on-lending to each other. Later Switzerland, not an IMF member, associated itself with the arrangements.

The **Group of Ten (G-10)**, as these countries are referred to, form an exclusive club. It always meets at the times of the IMF annual meeting and the spring interim committee meeting, usually at both deputy and ministerial level. The deputies of the G-10 finance ministers are charged to keep each other informed about balance-of-payments developments that could give rise to the use of the GAB. And along with OECD's Working Party 3, the G-10 deputies have played an important role in international monetary initiatives in the past 20 years.

In the early 1960s international liquidy was not keeping up with the expansion in world trade and output. Ministers and IMF governors of the G-10, therefore, at the IMF annual meeting in 1963 told their deputies to examine the probable future liquidity needs. The deputies reported that there might in time be need for some kind of reserve asset which would be additional to gold and the dollar. A study group was set up under the Bank of Italy's Rinaldo Ossola to examine various proposals for the creation of reserve assets. Its report was published in August, 1965; it envisaged the deliberate creation of reserve assets through IMF units or drawing rights, but did not make specific recommendations. The deputies, under the chairmanship of the Bundesbank's Otmar Emminger, then examined various proposals and held joint meetings with the IMF executive directors throughout 1966 and 1967. Eventually and after much wrangling — with France for a long time opposing the idea — finance ministers of the G-10 agreed in August, 1967, the outline of a contingency plan for the IMF to create **Special Drawing Rights (SDRs)**, that is to say, to create unconditional liquidity out of thin air.

The SDR was actually established in 1969, under the first amendment of the IMF's articles. Its value was originally defined in terms of gold, but it is now defined as a weighted basket of currencies — the dollar, DM, sterling French franc and Japanese yen. The first allocation was made on January

1, 1970, and the total stock of SDRs now stands at SDR21 billion, distributed as follows:

First basic period	1970-72 : SDR3 billion a year
Second " "	1973-78 : Nil
Third " "	1979-81 : SDR4 billion a year

During the period of the first three-year allocation of SDRs the whole basis of the international monetary system was changed by President Richard Nixon's decision on August 15, 1971, to sever the dollar's link with gold. Four months of uncertainty followed, with the G-10 meeting several times at deputy and ministerial level. The OECD's Working Party 3 tried to assess the scale of the adjustment required in America's balance-of-payments but failed to reach agreement. Finally, the G-10 ministers met at the Smithsonian Institution in Washington on December 17th. The **Smithsonian Agreement** provided a new set of fixed parities, but with wider temporary margins — 2.25 percent above and below parity — than in the Bretton Woods system. The dollar remained inconvertible.

The Smithsonian realignment was never realistic. Foreign exchange markets were nervous almost immediately afterwards. By June, 1972, the pound was under pressure and was floated "temporarily." In February, 1973, there was a second devaluation of the dollar, this time by 10%; by then the yen, Swiss franc, Italian lira and the Canadian dollar had joined sterling in floating. By March that year there was generalized floating.

Meantime, in the spring of 1972, agreement had been reached to establish a committee of the board of governors of the IMF on reform of the international monetary system and related issues — which became known as the **Committee of Twenty**. At ministerial level, the committee was composed of finance ministers and central bank governors; at deputy level by senior officials of finance ministries and central banks (in some cases, governors of central banks). Jeremy Morse (now Sir Jeremy Morse) was chairman of the deputies and a fulltime executive of a small bureau. The issues for the Committee of Twenty were: (1) balance of payments imbalances; (2) settlement of payments imbalances; (3) volume and composition of international reserves; and (4) special problems of developing countries. The committee produced an "outline of reform," but by then the uncertainties caused by widespread floating and the first oil shock made other problems more immediate and the committee was disbanded.

However, as provided for in the outline of reform, the governors of the IMF established in 1974 an **Interim Committee** similar in form to the Committee of Twenty. It acts only in an advisory capacity to the board of governors, but in practice its proposals are always adopted. The 22-member committee is described as "interim," because the IMF's new articles of agreement (revised for the second time in 1978) envisage a permanent and representative decision-making council. This council has not yet been established.

The interim committee meets twice a year. Two of its meetings so far have been particularly significant. The first was in Kingston, Jamaica, on January 7-8, 1976, when agreement was reached in principle on a new set of IMF rules — which were formally ratified just over two years later, in April, 1978. The main changes were: (1) Official price of gold was abolished; (2) Floating of exchange rates was legalized and under "Article IV," which sets out exchange rate arrangements, the IMF was given "firm surveillance" over exchange rates; (3) Higher quotas came into force; and (4) Use of SDRs was widened.

The second meeting was in Washington on February 10-11, 1983, when agreement, subject to ratification by member states, was reached to increase the total of IMF quotas from SDR 61 billion to SDR 90 billion and to endorse the Group of Ten's earlier decision to increase commitments under the GAB from SDR 6 1/2 billion to SDR 17 billion and make this enlarged amount available for on-lending to non-G-10 countries "if this is required because of a threat to the stability of the international monetary system." Switzerland has since become a full member of the G-10. Also Saudi Arabia is to be associated with the GAB and is prepared to contribute SDR 1.5 billion.

OECD (Organisation for Economic Cooperation and Development).

Founded in September, 1961, the OECD replaced the 13-year-old Organisation for European Economic Cooperation, a by-product of Marshall Aid, after President John F. Kennedy had proposed American membership. Today it has 24 members, all industrial countries; its non-European members are, besides the United States, Australia, Canada, Japan and New Zealand.

The general objective of OECD is to facilitate intergovernmental cooperation on questions of common interest to policy-makers throughout the OECD area. The secretariat today numbers about 1,800 of whom a third are classified as professional staff. About half of the 163 posts in the department of economics and statistics are professional.

OECD's governing body is the Council, on which each member country is represented. This meets regularly, with the heads of national delegations carrying the rank of ambassador; and from time to time, usually once a year, at ministerial level.

The greater part of OECD's work is carried out in its specialized committees and working parties which number more than 200. These committees are usually composed of senior officials from permanent national delegations to the OECD and are serviced by the secretariat. Two of these are particularly important to this study: the Economic Policy Committee (EPC) and Working Party 3.

The **Economic Policy Committee (EPC)** usually meets twice a year, in May or June and again in November, to discuss issues of economic management, both shorter-and-longer-term. Its members are senior officials from the ministries of finance or economics and from the central banks of each member country. Shortly before the EPC meetings a working group of EPC on short-term prospects discusses the secretariat's integrated economic forecasts, which are then presented to the EPC meeting. The discussions concentrate on the main macroeconomic policy issues, and have tended to foreshadow what has subsequently come out of OECD ministerial meetings on these issues. The secretariat's analyses and forecasts, as amended in the light of these discussions, are published in the July and December issues of the OECD Economic Outlook. Present chairman: Martin Feldstein, Chairman of America's Council of Economic Advisers.

Working Party 3, a specialized group of the EPC, is concerned with the impact of economic policies on the international payments and monetary situation, with the adjustment and financing of payments imbalances, and with the likely evolution of exchange rates and payments imbalances. It usually meets about five times a year. Membership is confined to the 10 largest OECD countries (the Group of 10 minus Belgium plus Switzerland) and members are senior officials from finance ministries (and similar agencies) and central banks of these countries. It is the main forum in which monetary and balance-of-payments problems and policies of the larger countries are examined, compared and debated. In the early 1960s it was the forum in which European criticisms of the American balance-of-payments deficit were aired. In recent years it has discussed problems arising from the development of a multicurrency reserve system, potential for extending the role of official institutions in recycling and the interactions between interest-rate variability, exchange-rate pressures and techniques of monetary control. Present chairman: Christopher McMahon, Deputy Governor of the Bank of England. Earlier chairmen: Emile van Lennep (then Treasurer-General of the Netherlands), Otmar Emminger (then Vice President of the West German Bundesbank), and Michiya Matsukawa (then Vice Minister at the Ministry of Finance, Japan).

The European Community (EC)

The European Community was established in January, 1958, with an original membership of six — Belgium, France, West Germany, Italy, Luxembourg and the Netherlands. It has since been expanded to ten, with the accession of Britain, Denmark and Ireland in 1973 and of Greece in 1981.

The **Monetary Committee**, which was set up in 1958, and the **Committee of Governors of the Central Banks**, which came into being in 1964, are the specialist bodies responsible for coordinating monetary policy within the Community. There is also the *Short-Term Economic Policy Committee* established in 1960 and since 1964 the *Budgetary Policy Committee*.

The Community's rulebook is the Treaty of Rome (signed on March 25, 1957). This was an original formula for the creation of an economic community which had no precedent in history. The Treaty contains detailed provisions for the organisation of the common market (free movements of goods, workers and capital), as well as a number of arrangements laying the foundation for economic union.

However, the Treaty confines itself to generalities when it comes to coordination of economic policies. Two documents on the subject became of prime importance: the Barre plan of February, 1969, and the Werner report of October, 1970.

The Barre plan (Raymond Barre, who subsequently became France's prime minister, was then the EC commissioner in charge of economic and financial affairs) contained detailed suggestions for concerted action. National medium-term objectives must be converged, Barre said, the main targets being related to growth rates in production and employment, price trends and the balance of payments. There must be concerted short-term economic policies within the medium-term framework and machinery should be set up for monetary cooperation.

The task of a group of experts, chaired by the then Prime Minister and Minister for Finance of Luxembourg, Pierre Werner, was to study ways of implementing these suggestions step by step. Werner's dilemma was to reconcile two opposing views. Monetarists told him exchange rates should be tied together first and economic unifications should come afterwards. Economists told him the European economies must be converged together first and only after that could exchange rates be bought together.

The Werner committee advised a compromise — progress on both fronts simultaneously. Cooperation in budget, monetary and regional policies was to go ahead in stages. At the same time margins of fluctuations in exchange rates were to be narrowed progressively until ultimately national currencies were replaced by a single European currency. European monetary union in its full sense was to be achieved by 1980. Fulfillment of these conditions would require the establishment of (1) a single decision-making center for economic policy, responsible to the European parliament; and (2) a community system of central banks.

Member states accepted the essentials of the Werner plan in February, 1971, with the narrowing of exchange-rate margins due to start in June, 1971. Even that move was postponed; faced with dollar weakness and currency upheavals in May, 1971, EC countries were unable to agree on a concerted policy. Then the Smithsonian agreement in December, 1971, widened rather than narrowed currency margins.

Nevertheless, the proposed narrowing of intra-community exchange rates came into being for the original six members in March, 1972: the maximum spread between any two member countries' currencies was set at 2.25 percent. But the joint European float — the *European snake* as it was known — was never a strong creature. The other EC members (Britain, Denmark and Ireland) joined in May, 1972, but defected in June, when sterling was floated, although Denmark rejoined in October, 1972. Italy remained in during that time only because it was given special inducement to do so and even that did not prevent its departure beyond February, 1973. France left in January, 1974, rejoined in July, 1975, but left again in March, 1976. On the other hand, two non-EC countries joined: Norway from May, 1972 to December, 1978, and Sweden from March, 1973, to August 1977. When it came in 1979 to turning the snake into a supersnake, i.e., the **European Monetary System (EMS)** the only remaining members were West Germany, Denmark and the Benelux countries.

The EMS differs from the snake it replaced in several ways:

1. Two major currencies, the French franc and Italian lira, came back into the system. Ireland, too, joined. Only sterling stayed out.
2. There is increased credit backing to support intervention.
3. The European Currency Unit (ECU) has been assigned new functions. Although it is still primarily an accounting instrument, central banks in the EMS can use ECUs for official settlements. So it is possible the ECU will develop as an infant European currency.
4. One-fifth of EC countries' reserves are now pooled, although for the time being there is no formal change of ownership — i.e., the reserves are only "lent".

At the end of two years of EMS, that is by March, 1981, the EC countries were supposed to introduce its second phase. That would have involved developing the ECU as a more convincing reserve currency and creating a European Monetary Fund (EMF), in place of the present **Euro-**

pean Monetary Cooperation Fund, which was expected to develop as a kind of European IMF. Countries would have genuinely pooled some of the reserves, depositing them with the EMF, and the EMF would have been responsible for all short-term and medium-term EC loans, as well as "conditional" credit-lines.

In fact, that second stage was postponed and no new date has been set for it. In the first four years of the EMS, there were seven realignments of currencies. It seems, therefore, that the EMS marked a step forward, but has yet to stand the test of time. Werner's goals have certainly not been achieved.

BIS (Bank for International Settlements)

The BIS, situated in Basle, Switzerland, is a bank for other central banks, able to do all types of banking business but with a clientele limited to central banks, especially those in Western Europe and North America. It was set up in 1930 to help organize German reparations. Its founders were leading Western central banks, not governments (though the governments signed the convention which gave the BIS special status). After a promising start, the banking business languished as a result of the 1931 financial collapse and did not pick up until the 1950s.

The BIS first came into its own in the late 1940s and early 1950s when it acted as an agent for the Intra-European Payments Agreements and then for the European Payments Union, a financial clearing arrangement between European countries.

In the 1960s it initiated new forms of international cooperation. The prototype Basle operation was provoked (as was the establishment of the Federal Reserve swap network) by the speculative capital flows that followed the 5 percent revaluation of the DM in March, 1961. At the end of Europe's most chaotic currency week since the second world war, the central bankers gathered in Basle (from Britain, Belgium, France, Italy, the Netherlands, Sweden, Switzerland and West Germany) announced they were cooperating closely in the exchange markets, and "no party to the so-called **Basle Agreement** should be forced by speculative movements of funds to deviate from the declared policy". The central banks stood ready in an informal way to help each other defend the parities of their currencies in two ways: (1) by three-month credits or swaps, e.g. if speculators switched dollars from London to Switzerland and these landed up in the Swiss central bank, the Swiss central bank would re-lend these dollars to the Bank of England, in the form of a three-month dollar deposit; or (2) if a foreign central bank started accumulating sterling because of a run on the pound it would simply hold it for three or six months and refrain from converting it, so deadening the impact of the withdrawal on Britain's exchange reserves. Not only did the BIS provide the forum for these Basle arrangements, but it also participated as a principal in most of them.

Official swap credits in a reciprocal bilateral network were also developed by the American authorities from 1961 onwards. The **Federal Reserve swap lines** with other central banks (11 in today's arrangements) provide for the Federal Reserve and the foreign central bank to exchange each other's currencies up to a maximum amount for an agreed period of three or six months, after which the transaction is reversed unless it is renewed (as it was frequently in the early days). The BIS also participates in this network on its own account.

In the 1960s Britain made most use of these short-term central bank credits, though France, Canada and Italy also had recourse to them. To begin with, Britain's use of these credits were either self-reversing or refinanced with other credits. Thus in 1961 Britain repaid $900 million from the central banks out of the proceeds of a $1.5 billion IMF drawing. But as sterling came under increasing pressure, the central bankers found themselves putting together special packages for Britain, such as the $3 billion short-term support package of November, 1964. Again Britain was able to repay when a longer-term arrangement was made in 1964 with the IMF.

Until 1966 the system of central bank cooperation had provided unconditional support for sterling. Then came two longer-term **Basle Group Arrangements** for Britain, to relieve it of the strains arising from sterling's role as a reserve currency. The first, negotiated in June, 1966 (renewed in March, 1967 and March 1968), assured Britain of a credit line of up to $1 billion provided the pressures on the pound arose from fluctuations in the official sterling balances held in London and not from Britain's balance of payments. The second, in 1968, involved more explicit conditions: Britain could make use of a $2 billion medium-term facility provided agreements were negotiated with sterling area countries whereby they undertook to hold a specified proportion of their reserves in sterling in return for a dollar-value guarantee. Some commentators saw this as a turning point at which monetary diplomacy became visibly politicized.

Central bank cooperation to help industrial countries did not stop in the 1960s. Britain and France relied heavily on it in the mid-1970s, though they were also at the time drawing on IMF credit. Britain, for instance, obtained a three-month $5.3 billion credit on June 7, 1976, from the central banks of the Group of Ten countries, together with Switzerland and the BIS, which was rolled over for another three months on September 7th.

Short-term lending to central banks is a traditional part of BIS business. But more recently, it has moved into a new field, providing pre-financing of IMF deals, acting as a joint supplier with central banks. Providing such finance for three to six months for Hungary, Mexico, Brazil and Yugoslavia represented the BIS's first sorties into this kind of lending.

From 1960 onwards European bankers felt that Federal Reserve participation in their monthly meetings was essential, even though the Federal Reserve had never picked up the BIS stock initially allotted to it and its attendance could be only in an observer capacity. Today governors of the central banks of the Group of Ten countries and Switzerland meet in the second weekend of 10 months of the year. The BIS also organizes periodic meetings of central-bank officials to examine matters such as the development of the gold and foreign exchange markets and the Eurocurrency market.

The BIS also provides the secretariat for the Committee on Banking Regulations and Supervisory Practices, which was established by the Group of Ten central banks in December, 1974. (This is now chaired by the Bank of England's Peter Cooke). It does likewise for the Committee of Governors of the EC central banks and for the Board of Governors of the European Monetary Cooperation Fund, for which it acts as agent. There is a standing committee systematically monitoring international developments; this meets quarterly.

The BIS has a large data bank designed to meet the needs of central banks and it is the main source of data on the Eurocurrency market.

GATT (General Agreement on Tariffs and Trade)

An international treaty signed in 1947 by 23 countries in order to set up an international trade organization and direct policies towards the reduction of trade barriers. Based in Geneva, the GATT is a specialized United Nations agency and there are now 87 contracting parties, with a further 31 countries applying GATT rules *de facto*.

When the **Kennedy Round** started in 1963, five multilateral tariff negotiations had already been conducted under the GATT since the second world war. This operation, prompted by President Kennedy's trade expansion act of 1962, was the most ambitious tariff-cutting exercise ever attempted. Negotiations lasted until mid-1967 and resulted in tariff cuts averaging over 35 percent on industrial products, and 50 percent or more on some items.

Another assault on trade barriers, the **Tokyo Round**, began in September, 1973 and ended in November, 1979. This time the tariff cuts, spread over eight years, were less significant than in the Kennedy Round, though for some individual items they were important — for instance, America's tariff on high-class woollen textiles was slated to come down from 44 percent to 33 percent. Some important codes were decided: one to prevent trade being hindered by technical standards and import licensing procedures; another to open up non-military government procurement to foreign competition.

International cooperation — a personal view

by Otmar Emminger

Dr. Otmar Emminger draws on his long experience in the field of international finance to provide the following personal view on monetary cooperation during the past quarter of a century.

1. Monetary cooperation in the Bretton Woods period up to 1973 was relatively good as long as it was easy to follow in the footsteps of the almighty dollar, which was pretty stable in terms of prices until the second half of the 1960s, and at the same time provided the rest of the world with ample gold and foreign exchange reserves. Already at that time, however, there were violent criticisms of each other's *non-cooperative* policies — e.g. Giscard d'Estaing's attack against the US at the IMF's Annual Meeting in Tokyo 1964 for their alleged flooding of the world with (inflationary) dollars, or the American attacks, in the first half of the 1960s, against the Europeans for disturbing the international equilibrium by inadequate capital market development. There were the attacks of de Gaulle on the dollar as a reserve currency, and in favor of a gold-based system, and the breakdown of the Gold Pool in 1968.

2. This is even more to the point; there was no real international cooperation with regard to the major currency adjustments. The French did it in 1957 without any prior warning; there was only cooperation afterwards when both the EPU and the IMF had to provide special loans (I participated in both negotiations). West Germany upvalued the DM in March 1961 without even consulting the IMF; the then Managing Director of IMF, Per Jacobsson, expressed his violent opposition, of which I got my share when I was sent to Washington by our government and the Bundesbank to broach him the news of the decision already made. The EC was so upset by the complete lack of previous information on the DM upvaluation, that in the EC Monetary Committee we had to work out an obligatory information pro-

cedure for similar cases in the future. Thus, when the British devaluation of November 1967 arrived, we had at least some preparatory discussions (in Basle and in a small group of leading officials in Paris, but only in the 8 days before the event) on the magnitude of the devaluation (up to which the others pledged to hold still with their own parities). I clearly remember that even at the time of the Fund's Annual Meeting in Rio in September 1967 it had been impossible to have a real talk on the pound's adjustment in a confidential group, even though the events pointed to a parity change sooner or later (there was some discussion between the British and the Fund's staff without information to the other countries).

3. The first real monetary "cooperation" came in the wake of the DM upvaluation in March 1961; its repercussion on the pound sterling led to the first Basle central bank swap credit for the Bank of England and also speeded up the establishment of the Federal Reserve's international swap network. In the 1960s there were several ad hoc central bank loan operations for the Bank of England, which were praised as good international cooperation (but criticized by others). The Gold Pool of the Basle central banks from 1961 to 1968 was also a well-meant piece of international cooperation in defense of the dollar; it was even reasonably successful up to 1965, but thereafter was doomed to failure by changed circumstances.

4. Such "cooperative actions" happened, of course, also after 1973, and some were more spectacular and much more successful, e.g. the huge 6 months' central bank loan of over $5 billion to the Bank of England in June 1976, which deliberately and in a well-planned fashion, paved the way for the British IMF drawing of December 1976 — the turning point for the pound sterling in the 1970s; or the concerted action for the US dollar in November 1978, etc. etc.

5. Of particular interest is the history of the last two years before the final breakdown of the fixed-rate system. The suspension of the dollar's gold convertibility in August 1971 (with all its attendant measures) was not discussed with any of the other interested parties. We were informed afterwards by a telephone call from the White House, and the next day by Paul Volcker in London. Only thereafter began a real discussion and negotiation over many months, leading to the Smithsonian Agreement of December 1971. But we could not complain; when West Germany went into temporary floating in May 1971, circumstances forced us also to inform our partners only after the event.

6. After the transition to floating, or rather from 1972 onwards, there was much more international discussion on monetary matters, including both domestic policies and exchange rates, than ever before. One reason was that in the EC the new European monetary arrangements, i.e. the

block-floating against the dollar, as well as the occasional exchange rate adjustments in the "Snake" and in the "EMS", inevitably led to continuous discussion and negotiation. The new European system made actual negotiation on each currency adjustment *de rigueur* — very much in contrast to the Bretton Woods era where no such open negotiation among the partner countries existed, with the exception of the Smithsonian Arrangement which was itself necessitated by unilateral action of the US (and West Germany).

7. Not only were parity adjustments different after 1973, but also discussions on other monetary matters assumed a different character. This was in part due to the fact that after 1973 the highly sensitive matter of exchange rate parities no longer blocked discussions on general policies. Moreover, a number of new high-level bodies — the Group of Seven (leading to the Summits), the Group of Ten, later the Group of Five — provided more effective and (mostly) confidential meeting grounds. On top of that, there were numerous ministerial and central bank governors meetings in the EC which in the 1970s talked incomparably more also on monetary and financial policies of member countries than before the 1970s. The OECD, too, became in the 1970s a more active forum for discussion and occasionally for policy coordination, in particular for cooperation against protectionism. There cannot be the slightest doubt that the machinery (or the mechanism) for international cooperation is markedly better today, as compared to the period before 1973.

8. Occasion for cooperative action was also provided by the oil price shocks, which — among other things — brought the IMF into focus, with its cooperative actions together with the central banks of the stronger countries etc. Kissinger's attempt at setting up a major "cooperation" in the form of a battle fund failed. But the International Energy Agency should not be overlooked as a platform for economic cooperation.

9. The international action on the occasion of the debt crisis is, of course, the most spectacular example of monetary and financial cooperation. Even if it should not prove a full success, it certainly showed a more cooperative spirit than most people would have expected beforehand. But even apart from this recent, very outstanding, example, the conclusion is justified that after 1973 there was not less, but equal or more, international cooperation on many monetary and economic matters.

10. It is, however, true that in some ways the year 1973 has been a dividing line *as concerns the character of international monetary cooperation*.

First, the introduction of monetarism in reaction to the high inflation of the early 1970s has inevitably strengthened an introverted attitude in monetary matters. Second, the goals of monetary cooperation have changed, as compared with the preceding period, in as much as, at least between the major currencies, the maintenance or attainment of a fixed exchange rate was no longer a direct goal (although the evolution of the floating rate has remained an important consideration for monetary policy in most countries.). The emphasis of monetary policy has shifted towards domestic stability, a matter of sheer self-defense against the worldwide inflation of the 1970s. It is, however, remarkable that in the end the concentration on the fight against inflation has produced, among a "stability group" of countries which comprise over half of the world economy, *a better convergence and lower inflation rates than in the last years of the decaying Bretton Woods system*. Thus there was no breakdown, but a strenghtening of monetary discipline under the floating rate system, while the fixed, but adjustable rates under the EMS have not been able to produce a similar result.

11. It is also true that in some respects there has been a deterioration in international cooperation since 1980/81 and this is mainly due to two reasons:

- — The recession and the distortion of major exchange rates (dollar, yen) have provoked strong protectionist pressures.
- — There has been a shift away from multilateralism, under the Reagan administration, especially as concerns international institutions.

12. Apart from the last point mentioned in the preceding paragraph, it could be said:

a) that the nature of cooperation, and more generally the nature and goals of economic and monetary policy altogether, have changed in accordance with changed circumstances, e.g. the changed position of the dollar, the transition to wide-spread floating, the attack from worldwide inflation, fostered also by the oil price shocks, the recession, exchange rate distortions etc.,

b) that the will toward good cooperation has not declined at all, especially among the monetary authorities,

c) that in some ways the position of monetary policy, and with it that of monetary authorities, has been generally strengthened, as compared with the 1960s,

d) that international economic interdependence has continually increased, and that this has, on the whole, been recognized and appropriate action taken,

e) that the available machinery for international cooperation is much more elaborate and refined than, say, in the 1960s and early 1970s.

Publications

Policy Statements:

Measures to Combat Inflation
The Group of Thirty

The Problem of Exchange Rates
The Group of Thirty

The World Economy Between Recession and Recovery
H. Johannes Witteveen

Study Group Reports:

Toward a Less Unstable International Monetary System
The Reserve Assets Study Group

Foreign Exchange Markets Under Floating Rates
The Exchange Markets Participants' Study Group

Balance-of-Payments Problems of Developing Countries
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